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UNITED STATES COPYRIGHT ROYALTY JUDGES

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IN THE MATTER OF:)

)

DETERMINATION OF RATES) Docket No.

AND TERMS FOR MAKING AND) 16-CRB-0003-PR

DISTRIBUTING PHONORECORDS) (2018-2022)

(PHONORECORDS III),)

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OPEN SESSIONS

Pages: 2985 through 3301

Place: Washington, D.C.

Date: March 27, 2017

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8 DISTRIBUTING PHONORECORDS) (2018-2022)
9 (PHONORECORDS III),)
10 -----X
11 BEFORE: THE HONORABLE SUZANNE BARNETT
12 THE HONORABLE JESSE M. FEDER
13 THE HONORABLE DAVID R. STRICKLER
14 Copyright Royalty Judges
15
16 Library of Congress
17 Madison Building
18 101 Independence Avenue, S.E.
19 Washington, D.C.
20
21 March 27, 2017
22 9:25 a.m.
23 VOLUME XI
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1 P R O C E E D I N G S

2 (9:25 a.m.)

3 JUDGE BARNETT: Good morning. Please be
4 seated. Ms. Buckley, are you lead this morning?

5 MS. BUCKLEY: Well, I do have the first
6 witness.

7 JUDGE BARNETT: All right then.

8 Good morning. Before you're seated,
9 would you please raise your right hand.
10 Whereupon--

11 STEVE BOGARD,
12 having been first duly sworn, was examined and
13 testified as follows:

14 JUDGE BARNETT: Please be seated.

15 MS. BUCKLEY: Your Honors, Copyright
16 Owners' witness is Mr. Steve Bogard.

17 JUDGE BARNETT: Okay. Mr. Bogard, would
18 you spell your last name for the record, please.

19 THE WITNESS: B-o-g-a-r-d.

20 JUDGE BARNETT: Thank you.

21 DIRECT EXAMINATION

22 BY MS. BUCKLEY:

23 Q. Good morning, Mr. Bogard.

24 A. Good morning, Lisa.

25 Q. In front of you, there is a copy of your

1 witness statement. And what I ask you to do is to
2 take a look at that and confirm to me that it is, in
3 fact, your statement that you submitted in this
4 proceeding.

5 A. Yes, that's it.

6 Q. And on the last page, is that your
7 signature?

8 A. Yes, it is.

9 Q. Mr. Bogard, would you just introduce
10 yourself to the Judges?

11 A. My name is Steve Bogard. I live in
12 Nashville, Tennessee. I'm a career professional
13 songwriter, although I've done record production and
14 been a musician and a performer in a past life.

15 I write for a publishing company. I've
16 been -- I've been a staff writer in Nashville for
17 over 30 years, done a song -- done songwriting for
18 over 40, 47, I think it is, when -- when you figure
19 it all out.

20 MS. BUCKLEY: I'd like to introduce Mr.
21 Bogard's written direct statement as Exhibit 3025.

22 MS. RAMOS: Your Honor, this is one of
23 the statements that was part of our motion in limine
24 filed earlier this month. We have no objection to
25 provisionally admitting the testimony subject to the

1 Court's decision on that motion in limine.

2 JUDGE BARNETT: Thank you. 3025 is
3 admitted, subject to the pending motion.

4 (Copyright Owners Exhibit Number 3025 was
5 marked and received into evidence.)

6 MS. BUCKLEY: Thank you, Your Honor.

7 BY MS. BUCKLEY:

8 Q. How many songs that you've written have
9 been recorded, Mr. Bogard?

10 A. By major artists, over 125. By
11 independent artists and aspiring artists, probably
12 another 2- or 300.

13 Q. And can you tell us some of the, I think
14 you said, major artists that you have written songs
15 for?

16 A. George Strait, Dierks Bentley,
17 Waylon Jennings, The Four Tops, Etta James, Dee
18 Dee Warwick, Conway Twitty, the Oak Ridge Boys,
19 Tanya Tucker, Reba McEntire -- is that enough?

20 Q. Have any of your songs topped the
21 Billboard charts?

22 A. Yes, I've had ten Number 1 songs.

23 Q. And would you name your Number 1 songs
24 and the artist who recorded them?

25 A. I don't know if I can remember all of

1 them, but George Strait did "Carrying Your Love With
2 Me" and "Carried Away." Reba McEntire did a song
3 called "New Fool at an Old Game." Dierks Bentley
4 did "Every Mile a Memory." Eddie Raven did "Till
5 You Cry." Lee Greenwood did "Mornin' Ride."
6 Jack Ingram did "Wherever You Are." And most
7 recently, Dustin Lynch did a song that just a few
8 weeks ago went to Number 1, and it's called "Seein'
9 Red."

10 Q. Thank you. And how many copies of albums
11 have sold with your songs on them?

12 A. According to RIAA awards and such, over
13 100 million. And if you count multiple occurrences,
14 multiple songs on albums, more like 150 million.

15 Q. And have you received any other awards or
16 professional accolades?

17 A. Two Grammy nominations, which when a
18 songwriter brags that he had a Grammy nomination, it
19 means one thing, you lost. Otherwise, I wouldn't
20 say it that way. No, I have two Grammy nominations
21 and -- and, you know, multiple 1 million, 2 million,
22 and 3 million performance awards from BMI, radio
23 performances.

24 Q. And in addition to your work as a
25 professional songwriter, do you advocate for

1 songwriters?

2 A. Yes. I -- I was president of the
3 National Songwriters Association International from,
4 I believe, '06 to '13. And I was on the Board for
5 about six years before that. And now I am an ex
6 officio Board member, old guy who knows a few
7 things.

8 Q. And can you tell the Judges briefly how
9 you became a professional songwriter?

10 A. I'll run through it quickly. At about 12
11 years of age, I -- I picked up a guitar, started a
12 band, began to write songs for a television show in
13 my hometown of Tampa so the band would get more
14 notoriety.

15 The band ended up getting a record deal.
16 I went to Memphis, Tennessee, and the band got a
17 record deal. We had a couple of singles on Scepter
18 Records. We took the band on the road, and when it
19 broke up and the road got too much for my -- my
20 teammates, I -- I ended up in Memphis writing for
21 Bill Black's studio. Actually, that was my first
22 introduction to professional songwriters, people
23 like Dan Penn and Don Covay, and I wrote a thing
24 that James Carr recorded called "Freedom Train."
25 That was a top 20 R&B hit when I was about, I guess,

1 20, 19.

2 And from there, I just followed -- I just
3 followed the music muse where -- wherever it led me.
4 I stayed in Memphis for a couple of years. Then I
5 got a chance to move to Miami with a rhythm section
6 called the Dixie Flyers, got to work with the
7 legendary Tom Doud and Jerry Wexler, and got to sit
8 in on sessions and have things recorded by Delaney
9 and Bonnie, Rita Coolidge, and was in on sessions
10 with Eric Clapton. I was there for Derek and the
11 Dominos and there for Aretha Franklin's "Spirit in
12 the Dark" and -- all of which was incredibly
13 inspiring, and all of which made me value my choice
14 to chase the music muse.

15 Q. And was there a point that you were
16 signed to a major publisher?

17 A. Well, yeah. Atlantic's publishing
18 company Cotillon signed another writer and I when
19 they signed the rhythm section. And we -- we
20 revelled in the magnificent sum of 100 dollars a
21 week for a couple of years until they left, until
22 Atlantic left. And then I spent probably 10 or 11
23 years in Miami just writing jingles, doing
24 production for television, and a lot of gigs. I
25 played base pedals, guitar, and drum machine at the

1 same time, and I was a play thing of the idle rich
2 for about 10 or 11 years.

3 Q. Did you have an exclusive songwriter
4 agreement with the predecessor to Warner/Chappell?

5 A. Yes.

6 Q. Publishing company?

7 A. Yes. We move -- we moved -- my wife and
8 I and my four- and eight-year-old moved with a few
9 grand and eight rooms of furniture to Nashville in
10 '82. And I quite rapidly got a deal with
11 coincidentally the same publisher that I had written
12 for in Memphis at a company at that point called
13 Welk Music, which later became Universal, was
14 engulfed by -- by Universal.

15 And so for a year or two, I had a
16 50-dollar-a-month draw. And pretty rapidly at that
17 point -- the projections were it takes about five
18 years to make a living back in '82. And within a
19 couple, within a year or two, I was writing with
20 really future Hall of Fame songwriters and was --
21 was getting cuts by major artists.

22 And, like I said, that was prior to the
23 Warner/Chappell years. Then I signed with Chappell
24 Music, got an amazing 300-dollar-a-week draw. At
25 the time, my kids were in private school. I was

1 down to about 15 bucks in my bank account and 200
2 dollar tuition bill to pay. And at the last minute,
3 Irwin Robinson signed me to -- to Chappell Music.
4 And I was there for a couple of years until the
5 Warner Music Group and Chappell did a merger. And
6 all together, I was at Warner/Chappell for 22 years.

7 Q. And what happened after you left
8 Warner/Chappell?

9 A. I left Warner/Chappell and went to
10 another Irwin Robinson company by coincidence called
11 Famous Music, which was owned by Paramount, and
12 wrote there for three years, wrote the -- couple of
13 the big Dierks Bentley songs and had some cuts.

14 And at -- at the end of my contract term,
15 the end of those three years, Sony/ATV bought
16 Famous, acquired Famous, and I had determined that I
17 could go off on my own and be my own publisher and
18 fund my own company.

19 We -- we signed an artist, got -- got a
20 group called Fast Ride signed to Big Machine, did
21 their -- did their management and their publishing.
22 And that turned out to be --

23 Q. Did that work out? I'm sorry.

24 A. No, that turned out to be fairly
25 disastrous. I learned an important lesson. Just

1 because you can do something doesn't mean you
2 should. And -- and I strayed from my core
3 competency, which is -- which is just really writing
4 songs.

5 And so after a pretty heavy financial
6 hit, I moved on, spent about two years looking for a
7 publishing deal in Nashville. And for the most
8 part, was told I was overqualified, was told --
9 despite all the success was told, yeah, guys like
10 you who are used to big draws, we get a lot of those
11 guys; we're not interested. Usually before money
12 even ever came up.

13 So after two years, I signed with a
14 company that's part of the BBR, Broken Bow Records
15 music group, which has just been acquired by -- by
16 BMG, the Bertelsmann Music Group. I signed to their
17 publishing company, Magic Mustang. Turned out to be
18 a really good fit because they had a lot of really
19 young artists and a lot of young songwriters.

20 And in Nashville today, the professional
21 songwriter is the adjunct professor at the artist,
22 so I write a lot of artist songs with artists. And
23 it turned out to be a really good -- good fit. And
24 I've been there -- I'm in my sixth year there.

25 Q. Did you testify in Phonorecords I while

1 you were president of NSAI?

2 A. Yes, I did.

3 Q. Do you recall what some of the issues
4 were at the time of Phonorecords I that were
5 affecting songwriters?

6 MS. RAMOS: Objection, Your Honor, this
7 is beyond the scope of what is included in his
8 written direct testimony.

9 MS. BUCKLEY: I don't --

10 JUDGE BARNETT: You don't disagree --

11 MS. BUCKLEY: I don't really think it's
12 beyond the scope.

13 JUDGE BARNETT: Oh, you don't think it's
14 beyond the scope?

15 MS. BUCKLEY: I believe Mr. Bogard's
16 statement refers to the fact that he testified in
17 Phonorecords I.

18 JUDGE BARNETT: Well, the question was
19 more than that. The question was about what were
20 the issues at the time. Is that addressed in his
21 written direct testimony?

22 MS. BUCKLEY: I don't think specifically.

23 JUDGE BARNETT: Sustained.

24 BY MS. BUCKLEY:

25 Q. In what way are songwriters struggling to

1 make a living today?

2 A. Well, I think, Number 1 is the entire
3 farm system of publishers funding the development of
4 young songwriters and the-- the years that it takes
5 to hone your craft and make the contacts, it takes
6 to create a career, which has traditionally been
7 funded by mechanical royalties, is -- is
8 disappearing or, indeed, has disappeared.

9 That started with -- that started piracy,
10 it started with Napster, and continued with the
11 unbundling of -- of albums, so that the writing -- I
12 can remember producing albums and -- and thinking in
13 terms of the four cornerstone pieces of the record
14 that the other songs would -- would sprout from, and
15 -- and wanting to have pieces of art, pieces of fun.
16 Our job is to make people feel things, and so in an
17 album you wanted to -- to really do the whole
18 spectrum of -- of loving and dancing and fighting
19 and -- and all of that.

20 And so with the unbundling, that became
21 less important. So album cuts didn't -- didn't
22 really matter. And now streaming, the current rates
23 of streaming are just unconscionably low. They're
24 -- they're laughable. I put a Facebook post that we
25 took yesterday in front of the Washington Monument

1 saying that I was at the CRB testifying to increase
2 streaming rates and hoping that the Washington
3 Monument was pointing in the right direction. And
4 just overnight, I got -- and I'm not a big Facebook
5 guy, but I got 188 "go get 'em," "atta boy," "I've
6 had millions of streams, never made anything."

7 So the songwriter, the mechanical part of
8 streaming is practically irrelevant. It's like
9 tipping a waiter a penny for a 200 dollar meal.

10 Q. And how do the mechanical rates for
11 songwriters for interactive streaming and CD sales
12 and permanent digital downloads compare?

13 A. Well, 9.1 cents split between all writers
14 and publishers is not exactly rolling in the hay,
15 but it provided -- and if it continued would provide
16 the basis for some kind of a living. No songwriter
17 comes to -- to Nashville or to New York or to Los
18 Angeles to get rich. Our goal -- my goal, for
19 example, I had a full scholarship to University of
20 Chicago, I had three or four scholarships in
21 Florida, could have gone on to an academic career,
22 perhaps been an esteemed counsellor of law such as
23 all of you, but, instead, I chased the music thing.

24 And no -- no qualified person is going to
25 want to go into the songwriting career if they can't

1 at least make some kind of a six-figure income, some
2 kind of a -- if you do write hits, if you're -- if
3 you're really good at your job and you work really
4 hard, you ought to be able to send a kid to college,
5 pay for a wedding, or -- and buy a reasonable
6 middle-class home. That's -- that's our goal.

7 And at one time, mechanicals would --
8 would fund that sort of a life. At this point in
9 time, it does not. And it doesn't even come close.

10 Q. How are songwriters earning money today?

11 A. Well, the only real income stream is one
12 that's unfortunately diminishing. The only
13 significant income stream is terrestrial radio. And
14 according to everything I read and hear, terrestrial
15 radio is a diminishing income stream.

16 So if -- if you're not the kind of
17 songwriter that can write -- you know, download
18 "Seein Red" or just go on Spotify and get it. The
19 kind of a thing that's a -- that's a fun up-tempo,
20 dancy, jingly song is the kind of thing we have to
21 write.

22 It doesn't mean that's a bad thing. I
23 love commercial music, and I like writing that sort
24 of thing, but you -- you have to write singles. And
25 you have to have your ear to the ground and know

1 what labels and artists are wanting to do in order
2 -- in order to make a reasonable living as a
3 songwriter.

4 Q. What is the -- the contribution of the
5 songwriter to the music ecosystem, if you will?

6 A. Well, NSAI turns 50 years this year. And
7 our motto is it all begins with a song. And there
8 would be songs anyway, but I think what -- what we
9 want to talk about is the professional songwriter
10 and the nonperforming songwriter, which is kind of
11 the same thing.

12 The professional content is the
13 difference between Jerry Springer and Downton Abbey,
14 and professional songs are the difference between "I
15 Hope You Dance" and what your 14-year-old kid writes
16 and you love it because they're your kid.

17 So that the contribution to the ecosystem
18 is we're the germ. We started off with a blank
19 piece of paper or we turn a musing of a -- of a
20 20-year-old artist in a real song that has impact,
21 that means something to people, that changes their
22 lives and moves them in some way and marks the
23 moments of their lives.

24 So from the song comes the recording
25 studio. The studio business in Nashville is in the

1 tank. Studio musicians who've really done nothing
2 but play on records and demos, publishing demos, for
3 years are out on the road with mid-level --
4 mid-level acts playing fairs. And you go from there
5 to all the business, the studio managers, the
6 recording engineers, the mastering engineers, the
7 PROs with their -- all their employees, the
8 publishing companies with all their employees, the
9 trade associations, the concert venues -- there
10 wouldn't be concerts without songs -- the concert
11 venues, the lighting, the sound, in other words the
12 entire music industry depends on the song and the
13 quality of the song.

14 Q. Have you invested time and effort in
15 pursuing a career as a professional songwriter?

16 A. Well, yeah, I've invested a lifetime. I
17 moved to Nashville with -- with a big wheel strapped
18 on the back of a U-Haul and virtually no assurance
19 of any kind of survival. And my wife came home in a
20 Red Lobster uniform three -- three months into the
21 process, and we traded off taking care of the kids.
22 And it's an adventure and it sounds like -- sounds
23 kind of soap opera-ish or lifetime movie-ish, but
24 it's what all of us go through. We invest -- we
25 invest our lives and our time into something that we

1 love.

2 And just because you love something
3 doesn't mean it isn't work. So what -- what I have
4 to do is -- is stay up-to-date on what's on the
5 radio, stay up-to-date on various -- various trends
6 in music, try to -- try to stay relevant at my age
7 with 20- and 25-year-olds who may have different
8 influences than I do. It is absolutely a full-time
9 job.

10 And if anyone in here is speaking to me,
11 I'm listening for a song title or a hook, and if you
12 don't realize it's a hook, I'll just write it.

13 Q. Do you believe that songwriters should be
14 guaranteed a certain life-style?

15 A. No, I don't at all. And I don't think
16 most songwriters do. It isn't -- it isn't about
17 life-style. It's about chasing a dream and about
18 moving people and about hearing -- I've had -- I've
19 had veterans who lost their buddy show me after a
20 show at the Bluebird a tattoo of "Every Mile a
21 Memory," saying that he and his buddy got -- got
22 that title tattooed on their wrists, and his buddy
23 didn't come home, and he just wanted me to know how
24 much it meant to him.

25 It's -- it's about those sorts of things.

1 And -- and, like I said, a reasonable living, if you
2 do your job well, if you really work at it, is -- is
3 the expectation.

4 Q. Mr. Bogard, the interactive streaming
5 services are opposing an increase in the compulsory
6 mechanical rates for interactive streaming because
7 they claim that they're not profitable and that
8 publishers are profitable and that songwriters are
9 not leaving the business but are actually entering
10 the business at record levels.

11 What, if any, response do you have to
12 that argument?

13 A. Well, I have a check from Google on my
14 desk for 2 cents for a large -- not a large --
15 probably a four- or five-song catalogue that did
16 well and charted. And I'm just holding onto it in
17 hopes that it messes up their accounting system a
18 little bit.

19 For Google and Amazon and Apple to say
20 they're not profitable, they operate in the free
21 market. They're allowed to charge or not charge
22 what they want. They're allowed to give away or not
23 give away what they want.

24 Songwriters are not allowed any of those
25 things. Songwriters are at the mercy of -- of you

1 three distinguished Judges, we're at the mercy of
2 the consent decrees. We're -- virtually the only
3 place where songwriters operate in a free market is
4 in the synch world, which coincidentally in the
5 synch world the sound recording and the underlying
6 work are 50/50. We get the same, which is, in my
7 opinion the relative value of the -- of the two
8 entities.

9 It's really patently absurd to say that
10 all these companies are not making money when they
11 can adjust their -- same with record labels, when
12 they can adjust their business model any way they
13 want, and we can't. I have had a tour named after
14 one of my songs, didn't make a penny. The Country
15 Music Hall of Fame just did an "Every Mile a Memory"
16 exhibit, didn't make a penny. They didn't call me.
17 I saw it on a billboard.

18 So that -- that doesn't make sense to me
19 because we are -- we are completely -- for two of
20 the three income streams, completely under -- under
21 the thumb of some kind of regulation.

22 Q. Is there anything else that you would
23 like the Judges to know in considering mechanical
24 rates for interactive streaming?

25 A. Yeah. I'd like them to know that if

1 terrestrial radio continues its downturn and by all
2 rights -- I mean, songwriters love the streaming
3 services. We love our music getting out there.
4 It's wonderful.

5 But if -- at these rates the professional
6 songwriter will disappear, professional content will
7 go away, because no self-respecting, intelligent
8 20-year-old is going to follow my path to -- to a
9 business that makes no money.

10 The fact that you mentioned that --
11 there are, I guess, anecdotal reports that there are
12 more songwriters now, there's a songwriter and
13 there's a songwriter. There's -- you know, there's
14 Dan Rather and there's Jerry Springer. There are
15 aspiring people. The dream is much larger than the
16 reality. There are lots of aspiring young artists
17 who make a CD and sell 12.

18 And it's fine if that's what they want to
19 do, but it doesn't boost the music -- it doesn't
20 boost the American music cultural contribution. It
21 doesn't boost the economy. It doesn't make our
22 music, "I Hope You Dance," "Somewhere over the
23 Rainbow" music, the music of the world.

24 And it won't just be financial. The loss
25 won't just be financial. It will be huge

1 culturally. It will be huge.

2 MS. BUCKLEY: Your Honors, we have seen a
3 couple of slick videos from the Services showing how
4 they're advertised and how they work. Would Your
5 Honors indulge Mr. Bogard to play a short song?

6 MS. RAMOS: No objection, Your Honor.

7 JUDGE BARNETT: We'd be delighted.

8 THE WITNESS: All right. What I thought
9 would be fun is if I just played a verse and a
10 chorus from a song as I wrote it, and then a verse
11 and a chorus from the actual recording. So this is
12 a George Strait song that was a four-week Number 1.

13 (Song played live in courtroom.)

14 THE WITNESS: So that's the short
15 version. And I thought I'd just play you a little
16 bit.

17 (Recorded song played in courtroom.)

18 THE WITNESS: Well, you get the idea. It
19 must have --

20 BY MS. BUCKLEY:

21 Q. And the idea is what, Mr. Bogard?

22 A. The idea is that the basic lyric and
23 music and harmony that one or two songwriters put
24 down has real value, as much value, at least, as the
25 recording that the brilliant producers and artists

1 do.

2 And that's my point. I think the value
3 -- I think songs are grossly undervalued in our
4 culture, and I would like to see that change.

5 MS. BUCKLEY: Thank you, Mr. Bogard.

6 JUDGE STRICKLER: Mr. Bogard, before the
7 cross-examination, I have a question for you. Good
8 morning, sir.

9 THE WITNESS: Good morning.

10 JUDGE STRICKLER: Thank you for the music
11 too.

12 THE WITNESS: You're welcome.

13 JUDGE STRICKLER: A question for you. Do
14 you believe the music publishers, as opposed to the
15 songwriters, are profitable?

16 THE WITNESS: Well, I think they're
17 surviving at the expense of developing more
18 songwriters. I really can't speak to their
19 profitability since I'm not an economist, but I
20 think they're surviving because of their flexibility
21 and because they're -- they're paying songwriters
22 much less in terms of draws.

23 JUDGE STRICKLER: You were the head of
24 one of the songwriters' trade associations; is that
25 correct?

1 THE WITNESS: I was the president of, a
2 volunteer job, of the National Songwriters
3 Association for -- for seven years.

4 JUDGE STRICKLER: And that was until what
5 year, sir?

6 THE WITNESS: Until -- from '06 to '13.

7 JUDGE STRICKLER: And as of 2013, did you
8 have the ability to learn whether or not the members
9 of the association, the publishers themselves, that
10 is, were profitable.

11 THE WITNESS: Well, there are no
12 publishers in our association. Ours is a totally --
13 we have no dogs in the royalty stream hunt. We're
14 totally -- we -- we survive on events and
15 membership. So what we do is we -- we advocate and
16 we help developing songwriters learn their craft.

17 JUDGE STRICKLER: So your association was
18 purely songwriters?

19 THE WITNESS: Purely songwriters and no
20 publishers on our Board. No publishers at all.

21 JUDGE STRICKLER: I think you also
22 mentioned at least three, maybe only three, avenues
23 of -- streams of revenue under the consent decrees,
24 through the PROs, terrestrial radio, and streaming.

25 I believe you -- was that accurate -- is

1 that an accurate recapitulation?

2 THE WITNESS: Well, our three streams of
3 revenue are synch, which is anything that goes with
4 a picture, a video or a film; performances, which
5 are all -- that's the part to which you refer about
6 the consent decrees and the PROs; and mechanicals.
7 Those are our three sources of income, mechanicals
8 referring to anything resembling a sale, a physical
9 product, whatever.

10 JUDGE STRICKLER: And have performance
11 revenues fluctuated over the last decade, say?

12 THE WITNESS: I think performance
13 revenues have stayed fairly -- fairly steady.

14 JUDGE STRICKLER: Okay.

15 THE WITNESS: I -- I know it's to the
16 PROs' advantage to -- to tout their -- their
17 collections and their revenue. Anecdotally, in
18 terms of my -- my contemporaries and my associates,
19 I think they've stayed fairly flat.

20 JUDGE STRICKLER: And how about the synch
21 revenues? Have they stayed steady, increased,
22 decreased, over, again, say, the last decade?

23 THE WITNESS: They have decreased
24 because -- again, anecdotally, they have decreased
25 because the mechanical royalty has diminished so

1 we're in less -- we're in a much less favorable
2 bargaining position in terms of what we -- that
3 is -- that is, Your Honor, the only -- the only
4 place where I'm allowed to say no, you can't put my
5 song in a movie for 2500 dollars; I need 3500.
6 That's the only place we can do that.

7 JUDGE STRICKLER: And how have
8 mechanicals compromised your bargaining position in
9 this market?

10 THE WITNESS: Well, because people are
11 hungry. People are -- there's not as much money
12 there to be made. And so in order to survive and
13 maintain, people have had to -- to compromise in
14 other -- in other areas.

15 JUDGE STRICKLER: And, generally
16 speaking, I know you can't -- although you're a
17 representative of songwriters here today, you can't
18 necessarily speak for all songwriters, but what is
19 the division of revenue from these three sources;
20 synch, performing, and mechanical among songwriters?

21 THE WITNESS: That's -- that's a
22 statistic, Your Honor, I'm not sure I could even --
23 I could even speak to. I mean, there are -- there
24 are lots of songwriters who specialize in synch, and
25 for them -- for them it's 75 or 80 percent of their

1 revenue. For me, for example, my revenue today
2 would be, I would guess, 30 percent mechanical,
3 65 percent performance, 5 percent synch, if that.

4 JUDGE STRICKLER: Do you think that's in
5 any way -- in any way typical or there's really no
6 way to say as it relates to the population of
7 songwriters?

8 THE WITNESS: I think that's -- I think
9 that's fairly typical. I think because I've had
10 some of these legacy country songs that are still --
11 that are still in our format specifically is the
12 slowest to adopt technology.

13 I think my mechanical royalties may, in
14 fact, be -- be stronger than -- than many because
15 there are still a lot of country fans who go out and
16 buy the CDs.

17 JUDGE STRICKLER: Do you know, generally,
18 what percent of songwriters are pure songwriters as
19 opposed to songwriters and artists?

20 THE WITNESS: That, again, I would be --
21 I would be guessing.

22 JUDGE STRICKLER: You don't -- you don't
23 have to guess. That's okay. I -- I don't want to
24 put you through that task. If you had a reasonable
25 estimate, given your experience, that would be one

1 thing, but don't -- but don't guess.

2 THE WITNESS: Well, it's kind of fluid,
3 is the point. A lot of times an artist, a
4 songwriter will come into town wanting to be an
5 artist, and the artist thing doesn't work out, but
6 they end up discovering they have this gift for
7 writing songs and also they have a talent for
8 interpreting and phrasing. And their voice, instead
9 of becoming the voice on the radio, becomes the
10 template for people like -- like George Strait or
11 Carrie Underwood to -- to make records with.

12 So it's kind of a fluid thing.

13 JUDGE STRICKLER: I understand. Thank
14 you, sir.

15 THE WITNESS: You're welcome.

16 JUDGE FEDER: Mr. Bogard, a moment ago
17 you said that for you the revenue is approximately
18 30 percent and 65 percent and 5 percent. How has
19 that changed over the last 15 years?

20 THE WITNESS: Oh, my -- my mechanicals --
21 during the, I'd say, the '95 to '05 period, my
22 mechanicals royalties averaged about 120 to 125,000
23 a year, and my mechanical royalties now are about 20
24 or 25. So it has been a steady decline. A little
25 of that is understandable because as the songs get

1 older, less people buy them.

2 But a lot of that is because, let's face
3 it, if you can have any song in the world any time
4 you want it, anywhere you want it, that's how you
5 want it. And streaming royalties, streaming
6 mechanical royalties are -- are not even relevant.

7 JUDGE FEDER: In your experience, that
8 decline, did most of it happen in the 2000 to 2005
9 period, 2005 to 2010? Was it a sort of a linear
10 drop or did it fall off a cliff at one point?

11 THE WITNESS: I would see it as a linear
12 drop, to tell you -- to tell you the truth. I would
13 see it -- as we talked about before, I would see it
14 as piracy, unbundling, streaming.

15 JUDGE STRICKLER: Could you identify
16 which of those three, if any, was more of a factor
17 in the reduction of your mechanical royalties?

18 THE WITNESS: I don't think I could -- I
19 don't think I could say. I don't think I know. One
20 of the things about streaming mechanicals is it's a
21 fairly new income stream.

22 So all we notice is that it's -- I
23 believe they said, RIAA said, it was 30 percent -- I
24 may be misspeaking -- of the music industry revenue.
25 But it isn't 1 percent of songwriter revenue. So I

1 can't speak to the timing, the timing of it, but I
2 know it's -- if radio continues to decline and
3 streaming continues to increase, it's going to
4 create an absolutely untenable position for -- for
5 professional songwriters.

6 JUDGE FEDER: When you get your
7 statements from the PRO, does it identify what the
8 sources of that -- that revenue is? For example,
9 does it tell you this much is from radio, this much
10 is from streaming, this much is from playing in bars
11 and restaurants and so forth?

12 THE WITNESS: Yeah, it doesn't really
13 identify general licensing bars and restaurants. It
14 does identify radio and TV. And it does -- it just
15 says digital. So that could be downloads. It could
16 be -- so I could be getting some DPDs, and I could
17 be -- some of it could be streaming.

18 JUDGE FEDER: And have you seen a -- a
19 change in the relative shares of, say, radio and
20 digital over the last 10, 15 years?

21 THE WITNESS: Well, digital downloads
22 have decreased. And the album --

23 JUDGE FEDER: I'm talking specifically
24 about the performance royalty.

25 THE WITNESS: Yeah, yeah. Yeah, digital

1 -- well, yeah, right. So that wouldn't affect. I'm
2 sorry.

3 I -- I really haven't analyzed my
4 statements to that -- to that extent.

5 JUDGE FEDER: Fair enough.

6 THE WITNESS: I wish I could say exactly.

7 JUDGE FEDER: Thank you.

8 JUDGE BARNETT: Mr. Bogard, you mentioned
9 piracy. And you also said that the -- the big
10 streaming companies operate in a free market, open
11 market, and that -- I think the implication, if not
12 the statement, was they're choosing not to make more
13 money on their streaming to the detriment of the
14 songwriter.

15 But if they were to increase the cost of
16 streaming, would that not open the door to a rebirth
17 of piracy, which is zero to the songwriter?

18 THE WITNESS: Right, right. I'll tell
19 you the truth, Your Honor, to most songwriters,
20 myself included, there's very little difference
21 between current streaming rates and piracy. There's
22 not enough difference to -- to even speak of.

23 Really what -- what I meant by that
24 comment was that there are ways -- just like when
25 record labels were having a hard time, there are

1 ways that the Services, in my opinion, operating in
2 a free market could perhaps redistribute where the
3 royalties went or -- really, I'm not a businessman,
4 that's why I am a songwriter, so I don't really know
5 the answer to that, but -- but I know that eating
6 the goose that laid the golden egg is not the
7 answer.

8 JUDGE BARNETT: Thank you. Thank you.
9 Anything further?

10 MS. BUCKLEY: Thank you, Mr. Bogard.

11 THE WITNESS: You're welcome.

12 JUDGE BARNETT: I have a question for
13 you, Ms. Buckley.

14 MS. BUCKLEY: Yes.

15 JUDGE BARNETT: Exhibit 3025, which is
16 Mr. Bogard's written direct statement --

17 MS. BUCKLEY: Yes.

18 JUDGE BARNETT: -- is marked as
19 restricted. But the copy that I have doesn't --

20 MS. BUCKLEY: It's not. There's nothing
21 in there restricted. I'm not sure why it is marked
22 that way.

23 JUDGE BARNETT: Well, the -- the copy I
24 had before wasn't marked restricted, so I was
25 surprised to see that the one in the notebook is

1 marked restricted.

2 MR. HARRIS: Your Honor, with the
3 restricted copy, all of the documents were marked
4 restricted and the gray line identifies the material
5 that is, in fact, restricted by the protective
6 order. So that's why you have the header there. To
7 be clear, however, that particular document in the
8 form you have it in your hands has no restricted
9 information in it.

10 JUDGE BARNETT: Okay. So that would
11 explain why I saw nothing gray-lined.

12 MR. HARRIS: Yes.

13 JUDGE BARNETT: And I don't think that's
14 very helpful, to us to mark everything restricted
15 when there are things that are not restricted.
16 Especially in our drafting process. We always send
17 it back to you for a check, but it's not helpful to
18 us, just so you know for future reference.

19 JUDGE STRICKLER: It's an example of a
20 problem of bundling.

21 (Laughter)

22 MS. BUCKLEY: Understood, Your Honor.

23 JUDGE BARNETT: Good morning.

24 MS. RAMOS: Good morning.

25 JUDGE BARNETT: I'm sorry, counsel, could

1 you introduce yourself?

2 MS. RAMOS: Certainly. Jennifer Ramos
3 with Pandora Media.

4 JUDGE BARNETT: Thank you, Ms. Ramos.

5 CROSS-EXAMINATION

6 BY MS. RAMOS:

7 Q. Good morning, Mr. Bogard.

8 A. Good morning, Jennifer.

9 Q. So when songwriters receive advances from
10 music publishers, mechanical royalties can then be
11 used to recoup those advances, correct?

12 A. That's correct.

13 Q. In contrast, with performance rights
14 royalties, those are paid directly to songwriters
15 through their affiliated PRO and those are not
16 subject to recoupment by the publishers, correct?

17 A. That's correct.

18 Q. And in connection with preparing your
19 written direct testimony, you did not conduct any
20 studies or analyses regarding changes in the number
21 of songwriters since 2006, correct?

22 A. I have not conducted any studies, no.

23 Q. It is also true that you did not conduct
24 any studies or analyses regarding changes to the
25 sizes of advances received by songwriters over the

1 past ten years?

2 A. No. My information is anecdotal and
3 comes from being a leader in this songwriting
4 community in Nashville.

5 Q. Understood. And your testimony in
6 response to Judge Feder's question a few minutes ago
7 regarding a linear drop, that's just your own
8 royalties, correct?

9 A. That was the question.

10 Q. Yeah. And did --

11 A. What did I see with my royalties. Yes.

12 Q. Apologies for interrupting you. You
13 conducted no studies on that, correct?

14 A. No.

15 Q. Mr. Bogard, between 1996 and 2006, the
16 number of professional songwriters had declined
17 substantially, correct?

18 A. Correct.

19 Q. And during that same time frame,
20 Nashville was particularly hard hit, was it not?

21 A. Correct.

22 Q. And it's also true that by 2006, only the
23 most successful songwriters were able to live on
24 their royalties alone?

25 A. Correct.

1 Q. And the introduction of peer-to-peer
2 networks and the rapid increase in music piracy had
3 also already, by 2006, caused your mechanical
4 royalties to drop significantly, had they not?

5 A. That's correct. Significantly but -- but
6 not dramatically.

7 Q. Moreover, by 2006, because of corporate
8 consolidation in the music industry and among radio
9 stations, there were far fewer opportunities for
10 professional songwriters than there were 20 years
11 ago?

12 MS. BUCKLEY: Objection, lack of
13 foundation.

14 JUDGE BARNETT: Sustained.

15 BY MS. RAMOS:

16 Q. By 2006, Mr. Bogard, isn't it true that
17 labels had begun to use controlled composition
18 clauses, which -- which reduced the compensation a
19 songwriter could receive?

20 MS. BUCKLEY: Objection, no foundation.

21 MS. RAMOS: Your Honor, within his
22 written direct testimony, he testifies regarding the
23 contracts that he had.

24 JUDGE BARNETT: Sorry. I was trying to
25 make sure the mics were adjusted. We -- we're

1 having trouble hearing right here, so we're
2 wondering what's going on back there.

3 MS. RAMOS: I'm also happy to speak much
4 louder, Your Honor.

5 JUDGE BARNETT: Thank you. The -- what
6 was your question?

7 MS. RAMOS: The question, Your Honor, was
8 that by 2006, labels had begun to use controlled
9 composition clauses, which reduced the compensation
10 that a songwriter could receive?

11 JUDGE STRICKLER: You're asking him if
12 that was true?

13 MS. RAMOS: If that's true.

14 MS. BUCKLEY: And, Your Honors, there is
15 no foundation for anything related to -- I'm
16 sorry --

17 JUDGE FEDER: Controlled composition.

18 MS. BUCKLEY: Exactly. It was just
19 slipping my mind.

20 JUDGE STRICKLER: She just asked if it
21 was true. She didn't assume it was true and ask him
22 to treat it that way. She asked if that's the case,
23 yes-or-no question.

24 JUDGE BARNETT: Overruled.

25 BY MS. RAMOS:

1 Q. Mr. Bogard, I'll ask -- I'll ask you the
2 question again.

3 A. Great.

4 Q. Is it true that by 2006, labels had begun
5 to use controlled composition clauses, which reduced
6 the compensation that a songwriter could receive?

7 A. I cannot tell you exactly when the
8 controlled composition practice actually came into
9 being. I think it has been going on for longer, for
10 much, much longer than that. And I don't want to
11 offer more than you're -- you're asking, but -- but
12 it did exist in 2006 and, obviously, controlled
13 composition would reduce a songwriter's mechanical
14 royalties, if he were in a very specific position of
15 -- that's it. It would not affect a song that a
16 songwriter wrote for another artist.

17 Q. Thank you, Mr. Bogard.

18 And, Mr. Bogard, indeed, by 2006, isn't
19 it true that many of the songwriters you knew had
20 stopped being professional songwriters?

21 A. Yes.

22 MS. RAMOS: No further questions, Your
23 Honors.

24 MS. BUCKLEY: I have nothing further,
25 Your Honors.

1 JUDGE BARNETT: Thank you, Mr. Bogard.

2 THE WITNESS: Thanks.

3 JUDGE BARNETT: You may be excused.

4 MR. SEMEL: The next witness we have is
5 Dr. Richard Watt.

6 JUDGE BARNETT: Before you're seated,
7 please raise your right hand.
8 Whereupon--

9 RICHARD WATT,
10 having been first duly sworn, was examined and
11 testified as follows:

12 JUDGE BARNETT: Please be seated. For
13 the benefit of the witness, it is Monday, March
14 27th, and you're in the eastern time zone.

15 THE WITNESS: Thank you.

16 MR. SEMEL: And just before we get
17 started, just so that you understand, we hope that
18 this session will be entirely public. The witness
19 has prepared some slides, and we have blacked out
20 two very small portions on the screen, not on your
21 paper copies, so we don't think it's enough to have
22 to clear the room, but there will be a couple times
23 when the witness may show you something but not say
24 it out loud just to avoid having to clear the
25 courtroom.

1 JUDGE BARNETT: Thank you very much.

2 DIRECT EXAMINATION

3 BY MR. SEMEL:

4 Q. And, Dr. Watt --

5 JUDGE FEDER: Mr. Semel --

6 MR. SEMEL: Yes.

7 JUDGE FEDER: -- is there a set of paper
8 demonstratives? Because I don't have them here.

9 MR. SEMEL: Yes.

10 MR. WEIGENBERG: I'll hand them out in
11 just a second.

12 BY MR. SEMEL:

13 Q. Dr. Watt, can you please state your full
14 name for the record.

15 A. I'm Richard Ian Watt.

16 Q. And can you tell us your profession.

17 A. I'm an economist.

18 Q. And within the field of economics, do you
19 have any specialties?

20 A. My specialty would be defined as
21 microeconomic -- applied microeconomic theory and
22 within that, I've worked in the areas of the
23 economics of copyright and the economics of
24 insurance, mainly.

25 Q. And can you give us a very brief overview

1 of your educational background in the field of
2 economics?

3 A. Okay. So my first -- my undergraduate
4 degree is from the University of Canterbury. And --
5 in economics and business administration. Following
6 that, I did a postgraduate course of study, also at
7 the University of Canterbury, and I -- that was in
8 economic theory.

9 And beyond that, I then went overseas on
10 a -- on a break, basically, which ended up placing
11 me in Madrid, Spain, where I enrolled into a Ph.D.
12 course at the Autonomous University in Madrid and
13 finished that Ph.D. in the early '90s. And the last
14 element, I suppose, of -- of that education process
15 culminated right here in D.C., where I did a
16 post-doc at Georgetown.

17 Q. And can you briefly summarize your
18 employment history in the field of economics?

19 A. So whilst I was studying the Ph.D. course
20 at the Autonomous University of Madrid, I was
21 employed there, it was my first job, academic
22 position as a lecturer. Went through the process
23 there for about 21 years, perhaps, through the
24 promotions process, and in 2006, was offered a
25 position back at the University of Canterbury, which

1 I accepted, and I've been there since.

2 Q. And have you published numerous
3 peer-reviewed articles in the field of economics?

4 A. I have.

5 Q. Have you authored and/or edited books in
6 the field of economics?

7 A. I have. I think there's about five books
8 that I've authored.

9 Q. Have you ever testified as an expert
10 before in the field of economics?

11 A. I've testified once in a proceeding in
12 New Zealand in 2009, I believe it is, and -- on the
13 issue of rate setting for terrestrial radio.

14 Q. And has any court or tribunal ever
15 refused to recognize your expertise in economics?

16 A. No.

17 MR. SEMEL: Your Honors, we offer
18 Dr. Richard Watt as an expert witness in the field
19 of applied microeconomics and the economics of
20 copyright.

21 MR. ASSMUS: No objection, Your Honor.

22 JUDGE BARNETT: Dr. Watt is so -- Dr.
23 Watt is so qualified.

24 BY MR. SEMEL:

25 Q. Dr. Watt, did you submit written rebuttal

1 testimony in this proceeding?

2 A. I did.

3 Q. I'm going to direct you to the binder in
4 front of you to two exhibits, if you could look at
5 the exhibit that's under tab -- it's towards the
6 back, it's H-3034. And -- and I'm going to ask is
7 this the report you submitted with your signature
8 towards the back of the report?

9 A. So -- okay, right at the back of the
10 thing. Having a bit of trouble with the size of the
11 table.

12 Q. Sorry.

13 A. Okay, yes, it is.

14 Q. And now that I've gotten you to the back,
15 I'm going to make you flip to the front. If you
16 could look at Exhibit 2619, is that the Appendix 3
17 to your rebuttal testimony?

18 A. 2619. Yes, it is.

19 Q. Great.

20 MR. SEMEL: Your Honors, we offer hearing
21 Exhibits 3034 and 2619 into evidence at this time.

22 MR. ASSMUS: No objection, Your Honors.

23 JUDGE BARNETT: 3034 and 2619 are
24 admitted.

25 (Copyright Owners Exhibit Numbers 2619

1 and 3034 were marked and received into evidence.)

2 BY MR. SEMEL:

3 Q. Dr. Watt, can you give us a brief
4 overview of the opinions that you offered in the two
5 exhibits that we just looked at?

6 A. Okay. So I was asked in the process to
7 read and provide my professional opinion on a
8 written direct testimony in this process by
9 Dr. Leslie Marx. And that's what I did. I looked
10 at her -- her report and provided my opinion on it.

11 Q. Great. And could you give us maybe just
12 a brief overview of -- of the opinions?

13 A. I had some slides. How do I get this to
14 work? Oh, there we go. Thank you.

15 So I have -- I looked at their document
16 in respect of two parts of it. They -- that I feel
17 that I was qualified to comment on, basically.
18 Those are the segments relating to economic
19 efficiency and the rate structure itself and the
20 section related to the Shapley analysis and fair
21 returns.

22 So I look at several bullet points
23 amongst each of those two things that we can get to.
24 I've got slides prepared for those -- those things.

25 Q. Great. So I notice the first one you

1 have there is -- is economic efficiency. Can you
2 give us an overview of your opinions that you
3 offered in -- in your rebuttal testimony concerning
4 Dr. Marx's opinions on economic efficiency?

5 A. Sure. So to start with, if you don't
6 mind, in the proceeding, I prefer to use the term
7 "welfare economics," which is what economists use
8 when we talk about efficiency and we talk about
9 producer/consumer surplus and things like that.

10 So the report submitted by Dr. Marx is --
11 that part of the report, at least, refers to welfare
12 economics and refers to how -- how the -- the rate
13 structure might or might not affect the welfare in
14 this -- in this world.

15 So I guess my first point that -- that I
16 came to, the first idea that -- this struck me
17 within this, Dr. Marx's report, is that there is a
18 -- there is a confusion between what the 801 factor,
19 first 801 factor, is attempting to achieve and what
20 Dr. Marks understands that it might achieve.

21 The -- the assumption in the report is
22 that availability of music is the same as use of
23 music. And I don't see that at all. The
24 availability of music is -- is firmly centered upon
25 incentivizing creators to write music and to publish

1 that music to make it available; whereas it's the
2 use, at the end of the day, of that music that will
3 determine total surplus.

4 So I don't see that the policy objectives
5 open the door for a welfare economics criteria.

6 JUDGE STRICKLER: Are you saying -- good
7 morning, by the way.

8 THE WITNESS: Good morning.

9 JUDGE STRICKLER: -- that if we were to
10 equate availability and use and treat them as
11 synonymous, then welfare economics would be an
12 appropriate tool to utilize?

13 THE WITNESS: So if we were to do that?

14 JUDGE STRICKLER: Yes.

15 THE WITNESS: Then I believe so.

16 JUDGE STRICKLER: Thank you.

17 BY MR. SEMEL:

18 Q. Did you evaluate the question of welfare
19 economics using that analysis and the rate being set
20 in this proceeding?

21 A. Sure. So the -- the proceeding that
22 we're -- that we're addressing right here is for
23 setting a price or a rate for a single input.
24 That's the musical works mechanical license rate.

25 On the other hand, there's a certain --

1 the other side of the market appears, and that's
2 where does -- where does welfare come from? At the
3 end of the day, welfare comes from a representation
4 of consumers under a demand curve and the price
5 that's offered to them for consumption.

6 So the -- there's a disconnect between
7 the rate structure that we're -- that is being
8 discussed here and the generation, at the end of the
9 day, of -- of welfare. Pricing is in control of the
10 Services, not -- not Copyright Owners, and so the
11 rates, as far as I can see it, don't -- don't
12 control the final decisions made by the Services.

13 JUDGE STRICKLER: Dr. Watt, you mentioned
14 before about demand, and you said it was a function
15 of utility --

16 THE WITNESS: I didn't say that but I
17 would agree to that.

18 JUDGE STRICKLER: I guess I was hearing.
19 Thank you. But can you give us a little more with
20 regard to where prices come from? What in economics
21 what underlies, I should say, the supply curve that
22 generates the prices when supply and demand
23 intersect?

24 THE WITNESS: Okay. So if -- if we are
25 to accept that there's a demand curve, then the

1 output supplier would presumably look at that demand
2 curve and make some sort of informed decision, a
3 business decision, around what price they should
4 offer to that demand curve and, therefore, what that
5 would generate at the end of the day from the
6 market, what level of sales they obtain, which then
7 tells us what the welfare is -- is in that market.

8 JUDGE STRICKLER: Is there a supply curve
9 in -- in the market?

10 THE WITNESS: Look, I don't -- that's a
11 hard question to answer right off -- I've not
12 thought about that -- that idea at all. I don't
13 know. Are you asking me to speculate a little on
14 that issue or --

15 JUDGE STRICKLER: Well, not if you have
16 to speculate, no.

17 THE WITNESS: I think I would have to.
18 I'd like to think about that a lot -- a lot more.
19 There are some -- clearly -- at least let me say
20 this, that economic theory points to certain markets
21 where there is no supply curve, per se, and other
22 markets in which there would be. Like a perfectly
23 competitive market, it's acceptable that there's a
24 supply curve.

25 You once you get into non-perfectly

1 competitive output markets, it's -- it becomes
2 really debatable.

3 JUDGE STRICKLER: If the marginal cost of
4 an additional stream in this market is zero, does
5 that interfere with the ability to identify a supply
6 curve in this market?

7 THE WITNESS: So of an additional stream?
8 So it seems to me rather than streams being the --
9 the unit that is of importance here, it's consumers,
10 it's subscribers, the whole -- it seems to me, at
11 least my understanding is that pricing is -- is done
12 in respect of -- of subscribers. So a unit would be
13 a subscriber rather than a stream.

14 JUDGE STRICKLER: So -- so the market
15 that we're talking about is the market for
16 subscribers, not -- not for streams?

17 THE WITNESS: That's what I would prefer
18 to see on an -- on an X axis of a supply and demand
19 graph, yes.

20 JUDGE STRICKLER: So is your report based
21 on a market that -- that assumes that this is a
22 market for subscribers as opposed to a market for
23 streams?

24 THE WITNESS: So I don't think my
25 report -- you could say that that's based on that

1 idea. But it's certainly forefront in my mind, that
2 that's the way I'm thinking about this market.

3 JUDGE STRICKLER: Thank you.

4 THE WITNESS: Thank you.

5 BY MR. SEMEL:

6 Q. So there was some discussion of -- of
7 pricing in there. And did you evaluate the
8 interplay of pricing and the -- the rate that's
9 being set in this proceeding?

10 A. Right. So I did -- I did have a look at
11 that idea. And --

12 Q. And I'm just going to interrupt you
13 here --

14 A. Okay.

15 Q. -- to remind you that there's a
16 blacked-out section --

17 A. Yes. Okay.

18 Q. -- on the slide.

19 MR. SEMEL: So Your Honors can see it.
20 We don't think he needs to say it out loud for you
21 to get the point of that example.

22 BY MR. SEMEL:

23 Q. So if you could just not discuss that.

24 A. I will. I did look at the -- at the
25 market, and -- and I was informed about the way

1 pricing looks to work in this market. And it's --
2 it seems to me that there isn't an obvious direct
3 connect between per unit of use input pricing and
4 the output pricing.

5 I haven't seen in this market any
6 examples of per unit use output pricing in spite of
7 the fact that there's a few examples there which I
8 won't -- won't talk about because one of them is
9 blacked out, but there's a few examples that exist
10 in the industry where there is per unit use input
11 pricing but not per unit use output pricing. So
12 there's -- so I did look at that.

13 Q. Just to clarify, you have SR, an
14 abbreviation. Could -- what did you mean by that?

15 A. Sound recordings.

16 Q. Got it. Okay. Continue, please.

17 A. So that leads me to believe that there is
18 this disconnect. There's something in between the
19 input pricing and the output pricing. And that
20 something clearly is the -- is the Services that
21 make their decisions about how to price an output.

22 I see no evidence or no theory, to -- to
23 be honest, about a hypothesized incentive to
24 discourage consumption, simply because there's a
25 positive input price, which is something that --

1 that troubled me, I suppose, by -- by reading
2 through Dr. Marx's report.

3 Input -- positive input prices are
4 universal pretty much, everywhere, in all sorts of
5 markets and in all sorts of scenarios. And yet they
6 don't lead to the output supplier attempting to --
7 to limit consumption or to turn -- to turn consumers
8 away.

9 JUDGE STRICKLER: Staying with evidence
10 for your theory for the moment, any way --

11 THE WITNESS: Yeah.

12 JUDGE STRICKLER: -- Dr. Watt, looking at
13 the first bullet point on the per-play royalty
14 rates, and to per-play user prices, did you have
15 occasion in doing your report to examine how
16 interactive streaming market rates in the United
17 States were set, whether they were set on a per-unit
18 basis in the upstream market or whether they were
19 done on a percentage-of-royalty basis or some other
20 or some --

21 THE WITNESS: The input prices?

22 JUDGE STRICKLER: The input prices, yes.

23 THE WITNESS: Yes, I understand that, so
24 I --

25 MR. SEMEL: I -- I don't want you to go

1 into any of the blacked-out area.

2 THE WITNESS: Yeah, I understand that.

3 No, but you were asking about the
4 structure, right?

5 JUDGE STRICKLER: Right, and whether
6 you've seen percentage of -- of revenue --

7 THE WITNESS: The numbers?

8 JUDGE STRICKLER: Not the numbers, just
9 the structure. Percentage of revenue or per-play or
10 something else or some combination overall in this
11 -- in the unregulated market, interactive market?

12 THE WITNESS: In the unregulated --

13 JUDGE STRICKLER: Unregulated,
14 interactive sound recording market.

15 THE WITNESS: Okay. I understand that
16 they -- in that market the -- the rates are set as,
17 in a bargain. And in some instances, there is
18 per-play -- per-play elements in -- in there.

19 I -- I couldn't claim to be an expert on
20 the way those -- those contracts look, but I do
21 understand there's elements within them of -- of
22 per-play rates.

23 JUDGE STRICKLER: Are there elements in
24 them of percentage as royalty as well, as far as you
25 know?

1 THE WITNESS: As far as I know? No, I
2 don't know.

3 JUDGE STRICKLER: Thank you.

4 BY MR. SEMEL:

5 Q. And did you -- did you look at economic
6 theory behind -- again, we're talking about
7 pricing -- behind service motivations for pricing?

8 A. Sure. So I think there's reason to be
9 clear, and it's a great assumption that or a very
10 realistic assumption that Services aren't welfare
11 maximizers. They're not motivated by welfare
12 maximization. They're motivated, on the other hand,
13 by profit maximization. They're business entities.

14 And so on that point, I think it's --
15 it's a bit lost in some of the things that I've seen
16 and -- and heard around -- this -- this process.
17 What exactly is profits and what exactly is profit
18 maximization? And I think it is important to clear
19 that up. And if you don't mind, I'll -- I'll say a
20 few words about it.

21 Because you take your standard -- you
22 know, you want to simplify your world and you draw a
23 demand curve and you talk about a supply and you
24 talk about a level of profit and a level of welfare.
25 That standard Econ 101 look at things is a single

1 period life of an enterprise, basically. So in the
2 real world, we've got, you know, a long life,
3 different periods. So if we want to equate the real
4 world to that simplistic theoretical construct, we
5 have to import all of the -- the life of the
6 business into one period.

7 So that actually is going to involve for
8 us in terms of profit and in terms of talking about
9 what this -- what this service is likely maximizing
10 to talk about bringing forward into the -- into the
11 prism all of the expected future earnings and
12 profits. And that's what they would be maximizing.

13 And if we step back from Econ 101 and go
14 to Finance 101, it's a standard assumption that the
15 -- the firms are maximizing the -- the value of the
16 firm, right? They're maximizing the -- the wealth
17 of its owners, and the wealth of its owners is
18 manifest in an -- in an expected value, expected
19 present value calculation, which turns up in the
20 stock exchange as what that -- what those shares can
21 be traded for and how much money you can put in your
22 pocket today by -- by selling your shares.

23 Q. And so when you say -- you just talked
24 for a second about future profits and -- is this a
25 hypothetical future value?

1 A. Well, the value is real. And you see it
2 in the stock exchange, right? You can take that --
3 that future present value today and put it in your
4 pocket. All you need to do is -- is walk down to
5 the stock exchange and do that.

6 So as -- when I say profit maximization,
7 that's what's in the back of my mind. I'm trying to
8 -- to, you know, cause a connection between a very
9 simplistic model and the real world that we're
10 facing.

11 So my feeling, then, is that the Services
12 would be maximizing profit in that -- under that
13 understanding and certainly not welfare as a
14 criteria. Therefore, since the -- the process that
15 we have doesn't bind Services in decisions, it can't
16 implement a welfare outcome.

17 There's a -- there's a gatekeeper between
18 the rate and the generation of welfare. And that
19 gatekeeper is the Services and their pricing
20 decisions to consumers.

21 Q. And, you know, earlier Judge Strickler
22 asked you about if you were to equate availability
23 with use and -- and apply welfare economics model.
24 Did you, assuming for argument, apply a welfare
25 economics? Did you analyze whether that would speak

1 to the rate structure?

2 A. Okay, so, yes, I did. And I've provided
3 a little appendix example which is a little toy that
4 shows that even if you were to -- to look at welfare
5 and think of welfare as -- or to look at how -- how,
6 you know, the rate structure of the input here might
7 affect welfare, you can't conclude that revenue
8 sharing will generate more welfare than -- than
9 would per unit pricing.

10 So the little example in there basically
11 is an existence kind of a concept. It says: Well,
12 I can always find cases in where -- in which the per
13 unit play, instead of revenue sharing, would
14 actually generate more welfare, simply on the basis
15 of there being a variety of different consumers out
16 there with different tastes and different
17 preferences.

18 On that point, though, I think -- and
19 I've been thinking about this issue -- it seems to
20 me that there's a missing element completely, a
21 completely missing element in the argument that is
22 put forward in the Marx Report about, you know, why
23 per -- you know, why if you bring into play a per
24 unit use input price, you would destroy welfare.
25 And that missing element is that what the proposal

1 is here is a substitution of one cost for another.

2 It's not the addition of a cost, full stop.

3 If you add the new marginal cost, if you
4 add in a per unit rate, of course, you will reduce
5 welfare, but in exchange, in substitution, you're
6 taking away another cost, which is the revenue
7 share, which has a manifestation into a marginal
8 cost function as well.

9 And that would have the opposite effect.
10 So there's a movement in two directions.

11 JUDGE STRICKLER: A moment ago -- I'm
12 sorry. Did you want to continue on with that?

13 THE WITNESS: No, I am fine. Yeah.

14 JUDGE STRICKLER: You mentioned before at
15 the beginning of your most recent testimony that
16 there are different levels -- different demands or
17 different customers in the market.

18 And is it fair to say that because of
19 that, revenue maximization can occur through some
20 form of price discrimination and it doesn't have to
21 be through a percentage of revenue? It can -- is it
22 your testimony it can be by varying the per stream
23 structure of rates as well?

24 THE WITNESS: Yeah, so -- okay, the
25 little example that I've got and that you're

1 referring to is Appendix 1, doesn't open the
2 opportunity necessarily for price discrimination.
3 It would open up opportunity for price
4 discrimination if these two consumers were visibly
5 somehow identifiably different. That wasn't --
6 that's not the idea of that example.

7 The idea of the example is that you can
8 price in one way; some consumers take that deal,
9 others don't. You price in another way; new
10 consumers can very easily come in, depending on how
11 that pricing structure changes, whether it's
12 worthwhile or not for them to -- to do that.

13 All you need is there to be a difference
14 in consumers across the market. And you can always
15 construct an example where that will happen.

16 JUDGE STRICKLER: And in this particular
17 market, if -- and tell me if you disagree with this
18 predicate, that the marginal cost of an additional
19 stream is zero, that we have -- we're having to deal
20 with a market that's considered a second best in
21 economic terms, and we have to figure out a pricing
22 structure or anybody in the industry, I should say,
23 has to figure out a pricing structure that will not
24 by definition be efficient because of the, well,
25 it's anomalous, at least compared to economics 101,

1 the situation where marginal cost equals zero? Are
2 we in that situation and, therefore, we have to
3 figure out different pricing structures?

4 THE WITNESS: Okay, so you're referring
5 to the fact, I think, that if, if, we were to
6 maximize welfare under -- under a perfectly
7 competitive -- in a perfectly competitive sort of a
8 world, this -- this axis would have to be priced at
9 zero; is that what you're referring to?

10 JUDGE STRICKLER: Yes.

11 THE WITNESS: And so nobody would make
12 any money, right?

13 JUDGE STRICKLER: Exactly right, in a
14 static one period analysis --

15 THE WITNESS: Yeah. So --

16 JUDGE STRICKLER: -- nobody would make
17 any money.

18 THE WITNESS: So, therefore, you -- yes,
19 you're absolutely right. But at the end of the day,
20 what I see here is not a perfectly competitive
21 world. What I see here is -- sorry, I mean, the
22 input price is one thing, but the output price in
23 your first first base world would also be zero. And
24 that's not the case clearly, right? There's a
25 positive output price that, if the marginal cost of

1 supplying output is zero, the positive output price
2 is hugely larger than the marginal cost.

3 So there is already some element of
4 competition that's allowing revenues to be
5 generated.

6 JUDGE STRICKLER: For those consumers who
7 have a willingness to pay of approximately zero in
8 the downstream market, isn't that problem solved by
9 having an ad-supported service, which is really a
10 two-sided platform, so that the -- the revenue does
11 not come from the listener at all, but comes from --
12 from the advertiser who imposes some level of time
13 cost or inconvenience cost, instead of a monetary
14 cost on those listeners?

15 THE WITNESS: Okay. So I have -- I have
16 a difficulty thinking about this ad-supported model.

17 JUDGE STRICKLER: I noted that in your
18 report.

19 THE WITNESS: And I haven't taken it into
20 any account in anything that I've done. All of the
21 -- the thinking I've done about this in the report
22 that I've submitted, I think refers to the -- to the
23 other -- you know, the paid subscription thing. The
24 ad-supported thing, you know, if you want -- if you
25 want to offer that service, if that service is good

1 for society, good for consumers, then it would have
2 to have value, right? It would have to be something
3 when you offer it, it has value.

4 If it has value, why don't more Services
5 offer it? As I understand, there's only one Service
6 offering this -- this product. The other Services
7 aren't offering it.

8 So if that's the case, should I be led as
9 an economist to believe that there is no value in
10 it; therefore, I should disregard it? Well, that's
11 one option. Another option is that there is some
12 barrier to entry for the other Services that
13 prohibits them from -- from taking advantage of this
14 -- of this great product.

15 And if I think that way, what barrier to
16 entry may there be? And it certainly isn't the
17 mechanical rate, right, that they can -- they can
18 have access to the musical works copyright.

19 And the only other copyright that they
20 need to offer the Services is the sound recording
21 one, so perhaps there's some barrier to entry there.
22 And no, I don't know what's going on and why that
23 might be that maybe they don't have that access, but
24 I suppose what I would be hesitant to advocate for
25 is that this rate setting procedure somehow

1 accommodates a scenario like that, of barrier to
2 entry.

3 JUDGE STRICKLER: Thank you.

4 JUDGE BARNETT: Is this a good place for
5 us to break?

6 MR. SEMEL: Sure.

7 JUDGE BARNETT: Okay. We'll be at recess
8 for 15 minutes.

9 (A recess was taken at 10:45 a.m., after which
10 the hearing resumed at 11:03 a.m.)

11 JUDGE BARNETT: Please be seated.
12 Mr. Semel.

13 MR. SEMEL: Thank you, Your Honor.

14 BY MR. SEMEL:

15 Q. Dr. Watt, I think where we left off, you
16 had been discussing or assuming, for argument sake,
17 you applied a welfare economics analysis and what
18 opinions you had.

19 And -- and I just want to ask, did you --
20 because I can't remember exactly where we left off,
21 did you have anything else you wanted to add
22 about -- in your report, assuming you did a welfare
23 economics analysis, what you would conclude?

24 A. Okay. Well, I think where we -- what we
25 were talking about was in my opinion there's a

1 missing element in -- in the analysis wherein you
2 bring in a per unit use rate. There -- there's an
3 additional marginal cost. There's an additional
4 cost factor, which -- which is taken into account by
5 -- by Dr. Marx, but then there's a removal of the
6 cost as well, which has the opposite effect. And I
7 think one plays off against the other, and how that
8 payoff works hasn't been -- hasn't been considered.

9 In the end, I think that as a summary
10 comment, it seems to me that the efficiency
11 arguments that -- that I saw throughout the Marx
12 Report basically reduced to an argument for pricing
13 flexibility on behalf of the -- the Services that --
14 to allow them to price however they would like in
15 order to maximize their -- their profits.

16 And it's not -- and it reduces
17 essentially down to an argument for lower royalty
18 rates. The -- but the statutory royalty doesn't
19 oblige the Services to spend extra surplus that they
20 may gain by price flexibility in any particular way,
21 certainly not to spend it in search of greater
22 welfare.

23 I would probably imagine that -- that
24 this isn't about rate structure so much. If -- if
25 the Services were offered a tiny little per use

1 rate, they would prefer that to a great big revenue
2 share rate. So that's - that's the way I read it.

3 Q. And -- and with the discussions about
4 this sort of pricing flexibility, in your report did
5 you look at economic theory on the relationship
6 between sort of price setting and the statutory rate
7 setting context?

8 A. Okay, yes. So, essentially, when I look
9 at the -- at the Marx Report, it's -- it's sending a
10 message that the rate-setting process should be an
11 attempt to -- to avoid pricing changes, where I
12 don't see that that's a logical thing at all.

13 Price changes, structural changes in the
14 market, the products that are offered, everything,
15 it happens all the time in response to market
16 conditions and changes that occur. I put a couple
17 of examples that are in the footnotes there of the
18 report there that-- it's already there, so we
19 shouldn't waste too much time talking about them,
20 but, you know, changes happen. And they seem to be
21 always accommodated quite nicely in the markets.

22 JUDGE STRICKLER: A question, counsel.
23 Of course, in this proceeding, we're setting rates
24 that are going to be locked in for essentially five
25 years.

1 Is a per-play structure or a percentage
2 of revenue structure better or worse in accounting
3 for the -- the inevitable changes that will occur
4 over the rate period?

5 THE WITNESS: So the idea of better or
6 worse, in -- in what sense would you like me to
7 understand that?

8 JUDGE STRICKLER: In terms of being able
9 to accommodate change, if we -- the -- having a --
10 the Copyright Owners have proposed a per-play rate
11 structure that would be effective for the entire
12 rate period. The Services are essentially proposing
13 some variation of what exists now under the 2012
14 settlement, which has a percentage of revenue
15 component to it.

16 Is one of those two structures better
17 able to accommodate the changes that may occur over
18 the course of the rate period?

19 THE WITNESS: Okay. So I haven't given
20 particularly much thought to that idea, but really
21 when I -- when I do think about that, the -- the
22 changes that may occur, it's an -- that's an
23 uncertain environment. And the one thing that is
24 certain that one can see is usage and subscribers,
25 numbers of subscribers, numbers of usage.

1 So a per-play rate introduces a lot of
2 certainty, where -- in an environment where changes
3 will happen; whereas the per unit revenue doesn't.
4 So I mean there's something -- there's something
5 that one could analyze in amongst all of that but
6 that I haven't had the opportunity to do so.

7 JUDGE STRICKLER: Thank you.

8 BY MR. SEMEL:

9 Q. Well, following up on that, though, did
10 you do an analysis --

11 JUDGE BARNETT: Excuse me.

12 MR. SEMEL: Oh, I'm sorry.

13 JUDGE BARNETT: You might get to this,
14 Dr. Watt, there are four policy factors.

15 THE WITNESS: Yes.

16 JUDGE BARNETT: And did you look at all
17 four factors?

18 THE WITNESS: Well, I've considered all
19 four factors.

20 JUDGE BARNETT: Okay. My question goes
21 to the disruption factor. What you're proposing is
22 different from the current structure. Did you look
23 at that in terms of the -- the fourth policy factor,
24 which is to avoid disruption?

25 THE WITNESS: Okay, yes, I did. And

1 there will be -- I'll get to that. You are ahead of
2 me a little bit.

3 JUDGE BARNETT: Okay. That's fine. As
4 long as we're going to get there, I -- I can hold
5 on.

6 THE WITNESS: Okay. Thank you.

7 JUDGE BARNETT: Thank you.

8 BY MR. SEMEL:

9 Q. Thank you. So following up on -- on
10 Judge Strickler's questions about sort of revenue
11 models versus per unit models, did you do an
12 analysis of revenue share models, as Dr. Marx had
13 discussed them, in your rebuttal?

14 A. Yes. So I have looked at -- at this
15 situation, and I won't go too far into this for Your
16 Honors because I know that there has already been a
17 lot of evidence presented about -- around the
18 definition of revenue and -- and what is it, what is
19 the revenue base. But, essentially, that's the
20 major problem here. The elephant in the room, as
21 far as revenue sharing is concerned, is that you
22 can't really measure that revenue properly.

23 And there are -- a revenue sharing
24 environment introduces certain perverse incentives
25 for -- for making that measurement problem even more

1 difficult.

2 Q. So in the beginning of -- of your report,
3 you talked about -- you also offered opinions
4 regarding the Shapley analysis that Dr. Marx engaged
5 in.

6 And can you maybe give us a little
7 overview of the opinions you offered on that topic?

8 A. Sure. So let me take the opportunity
9 while I'm here and in the Court to -- just to
10 express my -- my excitement that -- that the Shapley
11 model is beings used for such an important process
12 and such an important procedure here.

13 JUDGE BARNETT: That sentence could only
14 have been spoken by an economist.

15 THE WITNESS: Exactly. I'm sorry about
16 that. But, you know, it's -- it is something that
17 -- not only an economist, a theoretical economist,
18 right? It's great to see economic theory making a
19 difference.

20 And I think it's wonderful that this
21 Shapley modeling is being embraced by both -- by
22 lots of the experts in this proceeding and by both
23 sides. It's not surprising that that happens
24 probably because you've already asked me about the
25 factors. The Shapley model is written

1 essentially -- although it was written, I don't know
2 how the timing worked, but the Shapley model
3 accommodates two of these factors perfectly, the
4 second and third.

5 So, you know, it fits so nicely that it
6 isn't surprising at all that -- that it's brought
7 into play and people seem to like it. I think it's
8 also worthwhile to point out that it has been used
9 before in similar settings. I -- as I said, when --
10 when I was introduced that I was involved in a rate
11 setting process in New Zealand some eight years ago,
12 something like that. I provided a Shapley analysis
13 there, and that was what was convincing to the
14 Court, and they took -- they paid attention to that
15 and liked it. So it seems to work. And I'm really
16 happy that -- that it's still in play, right? Okay.

17 But that said, so I looked at the Marx
18 Shapley analysis, and -- and, unfortunately, I do
19 find that there's some flaws and methodological
20 issues that I think need to be addressed because
21 they are biasing the results.

22 And so if -- if you accepted that
23 analysis as it stands, essentially what it leads to
24 is a systematic reduction in the proposal for a
25 revenue sharing rate as -- as presented in the -- in

1 the Marx analysis. On the other hand, you know, the
2 -- the fact that the model is -- is good and it
3 works well, well, if you just correct for those --
4 for the errors and flaws, it, again, generates
5 decent, believable results.

6 BY MR. SEMEL:

7 Q. And can-- can you give just a basic sort
8 of outline of what the Shapley analysis is?

9 A. Sure. Of course, I can. So Lloyd
10 Shapley, rest in peace, has put together this model
11 back when he was a Ph.D. student. It's just amazing
12 stuff, really, but it's a model for -- for analyzing
13 complex strategic behavior in a very simple way.

14 And the goal of the model is explicitly
15 to -- to reward the relative contribution of players
16 who form coalitions, their contribution to the -- to
17 the achievement of the -- of a common goal, let's
18 say, the production of something. The model, what
19 it does is it allows us to capture a player's
20 necessity of bargaining power, including vetoes,
21 holdouts, everything, that the actual substance, the
22 real relationships and -- and everything that's
23 actually in the market, it allows us to import all
24 of that into a model that generates a fair
25 reflection upon each player of what they actually do

1 without any abuse of any -- any power that they may
2 have.

3 So, essentially, we can think of -- of
4 the model, what it does is it looks at how -- how
5 necessary each player is in the process of
6 generating a surplus. It allocates every single
7 possible role in -- in terms of ordering of -- of
8 players to each of the players, and it shares the
9 surplus that's generated in accordance with what
10 they actually provide and bring to the table in this
11 -- in this productive endeavor. Is that reasonable?

12 Q. Yeah, I think so, thank you.

13 And did you -- maybe you could outline
14 your main opinions concerning what you've just
15 described, this analysis as it's done by Dr. Marx.

16 A. So I found in the -- there are several
17 issues that bothered me and that I was concerned
18 about in Dr. Marx's analysis of the -- of the
19 Shapley scenario. The main ones here are these
20 three that I've put on this slide, that -- that is,
21 first and foremost, there is a modification in the
22 model that attributes necessity and attributes power
23 to a group of players that -- that don't have that.

24 So it's changing what actually is the
25 market setting and artificially allocating to some

1 players, the Services that are joined together in
2 Dr. Marx's model -- it allocates them artificially a
3 contribution that they don't really actually have.

4 So I think that this seriously introduces
5 a bias and it's one of the things that I certainly
6 looked at. This group of players are actually
7 highly substitutable, I'm led to believe, and it's
8 my understanding that the industry is in agreement
9 with this, that streaming services offer a very
10 substitutable service.

11 And yet, when you join them all together,
12 you're -- you're making them more necessary, each
13 one of them, than they actually are. So that's the
14 first thing that I looked at.

15 Q. Can you just quickly maybe elaborate a
16 little about how does that work? How is it that
17 joining them together, as you say, does this?

18 A. So if we -- if we imagine -- for example,
19 a corrected model that I've done. I had three of
20 them. Just -- just to choose a number, right? So
21 if you have three Services and one of them weren't
22 there, if the -- if the amount of output and surplus
23 that's created with only two is similar to what it
24 would have been with three, then the third player
25 really has a very small contribution.

1 But if you have them all together and you
2 eliminate it, well, there's a massive change there
3 to contribution. And so when you do join them all
4 together, you're attributing to all of those players
5 that are joined together a far -- you know, an
6 exaggerated level of necessity to what actually
7 exists in the -- in the market. Okay?

8 I think the second -- the second point
9 that I really thought was important in Dr. Marx's
10 analysis is the -- the numbers and the -- and the --
11 you know, the calibration of the model is based upon
12 a population of data that is now several years old.
13 And -- well, in and of itself, the use, the usage of
14 older data isn't a problem so long as that older
15 data is still relevant and a -- and a reflection of
16 reality these days. But when I looked at the growth
17 of this industry, it's completely different.

18 The -- the scenario that you had one year
19 after, when the data that Dr. Marx is using, if --
20 it's 2015 data there. If you just look at 2016, the
21 thing is double the size, right? There's a massive
22 problem when you use old data to -- to try and
23 reflect a new scenario.

24 So that's -- that's the other thing. And
25 I think that -- you know, we've talked, on an

1 earlier slide a minute ago, about this displaced
2 revenue. The revenue determines a lot of things
3 throughout the Shapley model. It determines --

4 JUDGE STRICKLER: Can we go back to the
5 other slide right before --

6 THE WITNESS: Yeah.

7 JUDGE STRICKLER: -- before this one?

8 MR. SEMEL: He has got the control.

9 JUDGE BARNETT: Thank you, Dr. Watt.

10 In the context of this slide, maybe not
11 related to this particular slide, but you made the
12 point about how the -- the contribution of the
13 Services was being exaggerated in Dr. Marx's model
14 because she treated them all as one, in essence, as
15 a monopsonist, I guess, of sorts, and that that's
16 not realistic because you have competitive services.
17 Is that a fair assessment?

18 THE WITNESS: That's what I'm saying,
19 yes.

20 JUDGE STRICKLER: In addition, at least
21 in her first Shapley analysis -- she has two
22 alternatives. In her first one, doesn't she also --
23 assuming that's true, doesn't she also -- on the
24 other side of the market with regard to the
25 licensors, doesn't she also change the market

1 structure and market power by identifying or by --
2 by, shall I say, lumping together sound recording
3 licensors and -- and musical works licensors on the
4 -- on the factual basis, I think as she puts in her
5 report, that there's a sufficient overlapping
6 ownership interest in the major publishing houses
7 and record labels that she thought that was a
8 reasonable bases -- basis to collapse them together
9 and treat them as having that level of -- that they
10 controlled both the sound recording right and the
11 mechanical right? Did you see that in her report?

12 THE WITNESS: Yes, I did.

13 JUDGE STRICKLER: And do you -- do you
14 agree with her doing that?

15 THE WITNESS: Okay. My comment on that
16 issue is what this model -- who is a player in the
17 model? Let's -- let's go -- take a step back there.
18 And the player in the model on the one side are the
19 -- the people who provide output to the -- you know,
20 who sell this final service to the market and those
21 are the Services.

22 On the other side who are players, and
23 the players are two input suppliers. It doesn't
24 actually matter if it's the same supplier. He has
25 got two inputs to sell. And so those -- the players

1 there are inputs, not necessarily individual firms,
2 right? Those are inputs. They're each -- each of
3 those two inputs is a necessary factor in making the
4 -- the enterprise happen.

5 JUDGE STRICKLER: The Cournot complements
6 that we've heard about?

7 THE WITNESS: Exactly. So if you -- if
8 you lump them together, right, you have the opposite
9 effect than what you had by lumping together
10 substitutable elements. You have lumped together
11 complementary elements where there is actually --
12 the market says, well, there's actually in reality a
13 greater necessity here, a greater power here that
14 needs to be taken into account, they should be
15 separated.

16 Now, I forgive Dr. Marx for doing that,
17 and -- and I did it myself because at the end of the
18 day, one of the features of the Shapley model is --
19 is computational complexity. And the more you
20 separate things out, the worse it gets, unless you
21 have a lot of computational fire power in your
22 computer, which I don't. Pen and paper guy like me
23 can't do that so easily.

24 So, you know, if I -- if I have to lump
25 together somebody, I would lump together those --

1 those input suppliers because the only effect that
2 doing that is going to have is depress further the
3 rates that the model predicts. So you get a more
4 conservative estimate.

5 JUDGE STRICKLER: It may depress the
6 rates, but let me ask you, I think at the end of the
7 day in your -- in your alternative approach, and
8 correcting for what you say are Dr. Marx's errors,
9 that you create or come up with a ratio of sound
10 recording percentage of royalties for sound
11 recording, the sound recording right, and to the
12 mechanical right. But if you -- if one were to
13 treat the owners of the sound recording right and
14 the mechanical right as the same, for purposes of
15 the analysis here, while that may, as you say,
16 depress -- depress the rate, does -- does treating
17 them as the same have any effect on the ratio that
18 we would then apply in the real world?

19 THE WITNESS: The ratio of --

20 JUDGE STRICKLER: Of sound recording
21 royalties to mechanical royalties in the real world?

22 THE WITNESS: Okay.

23 JUDGE STRICKLER: Because -- because
24 they're set in different ways. One is set in the
25 marketplace and one is set right here.

1 THE WITNESS: That's true. I have -- I
2 have at the back end of one of the exhibits, my
3 Appendix 3, a model that actually does that
4 explicitly, that takes that into account, that one
5 of the rates is set differently to the other.

6 And we -- we can get on to that. So,
7 again, you're a little bit ahead of me here. And
8 you're identifying the right issues, quite clearly,
9 as I -- so what -- what happens -- maybe -- I don't
10 know if I'm understanding your question exactly, but
11 what happens if we assume there's only one right, so
12 the right to broadcast music, and it's -- you know,
13 the two things are amalgamated into one and we treat
14 that as a single input?

15 If we do that, you know, you get the
16 sorts of results that come out of the models that
17 both Dr. Marx and I have done on that side of -- of
18 it. You get a single rate for all of the copyright
19 -- the copyrights that need to be cleared.

20 What it doesn't do, though, if you -- if
21 you stop there, it doesn't answer the question that
22 -- that's before this proceeding, which is only part
23 of that -- that copyright rate, right? You want to
24 know how that's going to be unbundled into
25 mechanical and sound recording, simply because we're

1 -- we're interested in setting only one of those two
2 rates.

3 JUDGE STRICKLER: Well, one of the -- one
4 of the problems or tasks that we have here is to
5 analyze the Copyright Owners' proposal. And I
6 understand you're -- you don't -- you're not a
7 direct witness; you are a rebuttal witness.

8 THE WITNESS: That's true.

9 JUDGE STRICKLER: But their theory of the
10 case is that we should look at the -- at the ratio
11 of sound recording royalties to mechanical
12 royalties. And if that ratio is somehow not
13 appropriate because it would be more realistic to
14 model the market as the market for -- for musical
15 rights generally, what does that -- what does that
16 do to the Copyright Owners' approach?

17 THE WITNESS: Right. I think what -- I
18 think we're really ahead of ourselves. And I'm -- I
19 am going to talk directly to this point about the
20 ratios here. Are you happy to wait for a couple of
21 slides and then ask me this question again?

22 JUDGE STRICKLER: Absolutely. But I just
23 have one more question about -- that relates to
24 this. The point you made about market power. It
25 really doesn't relate at least expressly to Dr.

1 Marx -- I think to anything that Dr. Marx says.

2 It's really something Dr. Katz said. I don't know,
3 did you read Dr. Katz's report at all?

4 THE WITNESS: I've seen his report -- his
5 direct testimony?

6 JUDGE STRICKLER: Yes.

7 THE WITNESS: Yes, I believe have seen
8 that.

9 JUDGE STRICKLER: I believe he makes a
10 point in his direct testimony -- he makes sort of a
11 passing reference or full reference to the Shapley
12 values. And he says it's a good tool, but one of
13 the potential pitfalls in using the tool is that it
14 assumes the existing level of market power in the
15 marketplace, and that might not reflect, a phrase
16 that he likes to use, effective competition.

17 Do you recall his testimony?

18 THE WITNESS: I don't recall it, no, that
19 particular point.

20 JUDGE STRICKLER: Well, let me ask you,
21 then, just generally, does the Shapley valuation
22 methodology as you have applied it in criticism to
23 Dr. Marx -- does it lock in the existing market
24 power of the players?

25 THE WITNESS: Yes. So absolutely, right?

1 And if you -- if you look at the -- at the original
2 Shapley paper and pretty much every single
3 application of the Shapley model throughout, you
4 know, economic history, what it's designed to do is
5 to capture exactly that feature. It's not -- it's
6 not designed to remove market power and necessity
7 from players. It's designed to value the market
8 power and their necessity.

9 What it does -- what it is designed to do
10 is to remove abuse of market power.

11 JUDGE STRICKLER: Would you consider
12 Cournot complementary an abuse of market power?

13 THE WITNESS: I wouldn't.

14 JUDGE STRICKLER: You would not?

15 THE WITNESS: No. I would -- so if a
16 good is necessary, if it's an essential input, and
17 another is another, a second essential input, well,
18 that's a reflection on the reality of -- of the
19 world. And that -- those two essential inputs need
20 to be -- need to be valued.

21 So when would it be an abuse of market
22 power? Well, if -- if the fact that you have an
23 essential input, in an unregulated environment, the
24 fact that you have an essential input implies that,
25 you know, time after time in every bargaining

1 negotiation that happens, you can hold out. You can
2 always be the last person at the table, and nobody
3 gets anything until you sign.

4 If that always happens, then there's --
5 there is an argument there for abuse. There would
6 be argument for abuse if I have an essential input
7 and I only -- I only decide to negotiate with some
8 of -- of the potential users of their input, not
9 all. All right?

10 I do that, something like that. Well,
11 that is also, I suppose, some kind of an antitrust
12 abuse of a dominant position.

13 What the Shapley model is going to do for
14 us is to not allow that to happen, but to retain the
15 idea, the natural idea, that in that world that good
16 is very important and it's very useful and very
17 necessary for the -- for the productive endeavor to
18 go ahead.

19 So how does it remove this abuse of
20 market power? Simply by making sure that each of
21 the players arrives randomly, they have no choice
22 that at every single instance of bargaining, they
23 always arrive last, for example, or that at every
24 instance of bargaining, they eliminate some of the
25 potential users. All of the players are introduced

1 into the model, all of them in each of the -- in
2 each of the positional orderings of -- that create
3 this -- this good that's going to be shared. And so
4 there's no way that that model allows an abuse of --
5 of market power.

6 JUDGE STRICKLER: Would it be fair to say
7 that a -- a way to distinguish how you approach
8 using a Shapley value in response to Dr. Marx and
9 Dr. Marx's own way of doing it is that, in her
10 report, she uses the Shapley value and then adjusts
11 for market power because her conception, in any
12 event, of fairness under the 801(b) factors requires
13 such an adjustment, and your understanding of the
14 Shapley value -- values are that they already
15 incorporate everything an economist would say is
16 fair and there's no need to make a further
17 adjustment to create a fairer outcome?

18 THE WITNESS: Okay. Indeed, that's my
19 opinion. That's the way I think about that.

20 JUDGE STRICKLER: I keep saying one last
21 question, and there's never a last question.

22 THE WITNESS: Sure.

23 JUDGE STRICKLER: Do you have, in your
24 report or in your appendix, an analysis of what the
25 rates would be if you corrected for what you say is

1 one of Dr. Marx's errors and that is her aggregation
2 of the Services as one unit with more power than
3 they really have in the market, but leaving --
4 leaving the -- but making only that correction?

5 THE WITNESS: Okay. Actually, I did the
6 opposite. So I looked at -- we'll get to that as
7 well. I do have another slide on that. But just to
8 let the cat out of the bag, if you like --

9 JUDGE STRICKLER: Spoiler alert, as it
10 were.

11 THE WITNESS: Okay. I did -- I did
12 correct sequentially for the -- for the errors that
13 I noted. And -- but I did it the other way around.
14 I first left her model alone and corrected for the
15 data inputs, and then I added to that a correction
16 for the -- you know, the structural elements within
17 the model.

18 What I didn't do was correct for the
19 structural elements and leave the data first. I
20 didn't do that.

21 JUDGE STRICKLER: Okay. We'll see the
22 detail as we go along.

23 THE WITNESS: You will, yes.

24 JUDGE STRICKLER: Thank you, Doctor.

25 THE WITNESS: So we were sitting --

1 BY MR. SEMEL:

2 Q. We were --

3 A. We were sitting here somewhere, right?

4 Q. Yeah. Just one quick follow-up, though,
5 along Doctor -- Judge Strickler's questions about
6 the different conceptions of the model.

7 If you were to, say, use the word
8 "correct" or "modify" a Shapley analysis to adjust
9 the market power of the participants, would you
10 still call it a Shapley analysis?

11 A. If you do that, you're cutting the heart
12 and soul out of the model. And, you know, Professor
13 Shapley would cringe in his grave and clutch his
14 Nobel medal closer to his chest. It would no longer
15 be validly a Shapley model per se because the
16 Shapley model, as we have, you know, on several
17 occasions tried to, you know, make it clear, it's
18 there and it's in place to measure the necessity and
19 the market power.

20 Indeed, if you look at -- you know, maybe
21 I don't know if it's -- how relevant it is, but the
22 Shapley model is used in a companion paper to the
23 original one to measure market power in voting
24 markets, but it's there to say, well, how much
25 market power do you have? Well, run a Shapley on it

1 and see how much market power each individual has.

2 The Shapley is measuring that. It's
3 there for that purpose.

4 JUDGE STRICKLER: Is it fair to say,
5 then, that in your Shapley analysis, you create --
6 you end up with rates that you would say are market
7 rates, whereas Dr. Marx does not?

8 THE WITNESS: So if you left it to the
9 market unregulated, you could expect possibly some
10 abuse of -- of the market power that's inherent
11 here. That's what the Shapley is not going to
12 allow.

13 So I would expect that in an unregulated
14 environment, there may be some elements that creep
15 in and some usage of the market power in a way that
16 benefits the -- the holder of that market power over
17 and above his natural contribution to output.

18 JUDGE STRICKLER: But -- but your Shapley
19 critique of Dr. Marx, the way you approach it,
20 creates an alternative market rate that does not
21 include an abuse of market power?

22 THE WITNESS: Exactly. So if you
23 thought -- if you saw a market working independently
24 of any regulation and you thought, you know, you had
25 no reason to believe that market power was being

1 abused, then, yes, you would expect that the Shapley
2 should at least approximate that pretty closely.

3 JUDGE STRICKLER: Thank you.

4 THE WITNESS: Is that a fair answer?

5 JUDGE STRICKLER: Yes. Thank you.

6 BY MR. SEMEL:

7 Q. So just going back to where we left off,
8 I think you were talking about the --

9 A. The data.

10 Q. Did you -- can you explain sort of this
11 last bit about displacing revenues, how -- what is
12 your issue with that? How is that a problem?

13 A. Okay. So I think it's -- I think it's
14 generally accepted and there has been a lot of
15 evidence about how difficult it is to actually
16 measure the revenue here.

17 The Shapley model, as we have said, is a
18 coalition or a group of productive individuals or
19 firms, players, getting together to create
20 something. And that something is a surplus. And
21 that surplus starts with a revenue, okay?

22 The amount -- so the workings of this
23 model -- and I've got some -- something about it in
24 a minute, but the workings of this model rely
25 heavily on us being able to denote what revenue

1 associates with the usage of the inputs. We have to
2 know that.

3 It generates the sharing rules
4 themselves. You need to know the revenue amounts to
5 generate those sharing rules. And then you need, of
6 course, to apply those sharing rules to something to
7 be shared, which, again, is revenues. So there's
8 two -- two parts of that -- of that displaced
9 revenue question there.

10 So it would be great to -- you know, to
11 -- if the model could include really the revenue
12 that attaches to usage, and displaced revenues is a
13 wedge there, definitely.

14 BY MR. SEMEL:

15 Q. Can you maybe explain -- I'm going to try
16 to get you to elaborate a little bit more on how the
17 displacement affects the model in sort of a --

18 A. Okay. So what I've done is put together
19 some graphics because I don't want to put my
20 equations up in front of the Court. I would -- I
21 could get terribly -- I could have a terrible time.

22 So here's a graphic that I think will
23 explain the way the model works and the effect that
24 what I consider to be these flaws in the -- in the
25 model, the data flaws at least here, happen. So if

1 you can see the disk here, the outer disk, the outer
2 edge of the whole disk and everything within it,
3 imagine that that's the revenue that's -- that's a
4 measurement of revenue.

5 The inner disk, the green-colored thing,
6 is that part of revenue that isn't -- isn't used up
7 by cost. So that's the surplus. That's the profit.

8 So here I've got a graph and I've got
9 like four players. Depending on how necessary they
10 are and what their scenarios are, that green -- the
11 Shapley model, what it does is it divvies up the
12 green area, the surplus, over the four players. So
13 we can see here arbitrarily I've just -- well, I've
14 made a division so it looks like player A is more
15 necessary than player C, but there's a division.
16 The whole surplus is divided.

17 Q. And just to be clear, what does SZ mean?

18 A. Oh, it's V. Sorry. The Shapley value.
19 That's -- that's what the model is -- is generating
20 for us. So that -- that would be the Shapley value.
21 That's what is calculated in the model.

22 What about what these players get paid at
23 the end of the day? How do we -- how do we do that?
24 Well, each player should be due -- so at the end,
25 you have to -- you have to distribute all of the

1 revenue, okay? So the revenue is distributed
2 amongst costs and surplus. The surplus would be
3 divided according to those divisions, which come out
4 of the model naturally, and then each player would
5 be allocated back, you know -- you know, the costs
6 that each of those faced, non-content costs, of
7 course, right?

8 So, for example, player A, the biggest
9 one there, receives as total payment back that top
10 segment of the green area, plus the player in blue,
11 right, so plus the blue ring as well in
12 reimbursement of costs. And that would be his share
13 of revenue.

14 Q. And just to be clear, are the costs also
15 determined by Shapley formulas?

16 A. No, they're -- no they're given. The
17 costs --

18 Q. Are they --

19 A. The non-content costs, that is -- that's
20 an input parameter into -- into this model. The
21 costs will determine the way the -- that the
22 splitting up happens, right?

23 JUDGE STRICKLER: Because the costs have
24 to be recovered?

25 THE WITNESS: Yeah, but they'll also

1 determine how everything works, right? So it's an
2 integral part. Let's just leave it at that.

3 Okay. So what happens when -- when
4 there's a revenue displacement or when there's an
5 overstatement of costs? So here's a revenue
6 displacement by this gray person, player C.

7 A revenue displacement essentially means
8 that there's some amount of revenue that should be
9 in the green disk but isn't. It's retained by one
10 single player instead of being distributed in those
11 proportions amongst all of the players.

12 So now player C is in a walk-away from
13 this world with the -- the gray -- the gray
14 reimbursement of costs, the new shaped area there of
15 displaced revenues that haven't been submitted to
16 the pool for sharing, plus player C's original
17 segment out of the -- out of the actual surplus that
18 is -- that was placed upon the table. That guy has
19 now got a larger reimbursement, a larger share of
20 revenue, shall we say, than what he's entitled to.

21 That -- the displaced revenue should have
22 been shared out. The sharing out of it, what it
23 would have done would be to increase the percent of
24 revenue of all the other players appropriately.

25 So that's displacement of revenue. On

1 the other hand, here's a guy who overstates his
2 costs somehow. The overstatement of costs eats into
3 that sharable revenue, I'm sorry, the sharable
4 surplus because the costs are allocated back to each
5 player as they -- as they fall.

6 And so if that yellow player is able to
7 overstate their costs, now the yellow player is
8 going to get back his -- his original cost plus this
9 overstatement, plus his -- his share of the revenues
10 there -- of the -- of the surplus.

11 And, again, that player's total share of
12 the -- of the whole disk, right, his share of
13 revenue, is -- is now overstated and greater than
14 what it should be. And, correspondingly, the
15 others' is smaller.

16 BY MR. SEMEL:

17 Q. And I think you mentioned that in your
18 report, you-- you attempted to evaluate or correct
19 for some of the flaws you found. Can you explain
20 how you tried to do that in your report?

21 A. I did. Okay. So as I said earlier, I
22 did two things here, right? The first thing I
23 looked at, the most -- and I think it was the most
24 -- well, I don't know, the most blatant thing
25 because I did see first the data in this industry

1 and saw how incredibly different it -- it is now, a
2 year, two years on, from the data that was used.

3 So the first thing I did was find out
4 what effect data itself has in -- in this model. So
5 I used exactly the same methodological setup, which
6 I am not in agreement with, and just changed the
7 numbers. The only -- the only numbers I changed as
8 well were the ones that I saw are likely to have
9 impacted upon this because those were the numbers I
10 think are the ones that are definitely different.
11 The amount of revenue that's -- that's on the table
12 and the ratio of costs to revenue that these players
13 will have.

14 So I've kept the -- the same set of
15 scenarios, the same, you know, robustness, I
16 suppose, check over what might happen. And when I
17 did that I find that the -- the royalty rate -- this
18 is the baseline model in Dr. Marx's report -- that
19 the royalty rate for all of the copyrights combined
20 goes up by about 10 percentage points, more or less.
21 It depends on which of the scenarios you want to
22 look at.

23 So then, secondly, I looked -- I got into
24 the idea of the -- the modeling structure. And,
25 again, I wanted just to see one -- one change, and I

1 think I mentioned why I didn't do two changes. The
2 two changes I could have done would have been to
3 separate out on both sides of the market, but it
4 would lead me to too many players, and my pen and
5 paper wouldn't do that for me.

6 So I've just left the rightsholders
7 together in the first instance. And I just wanted
8 to -- I wondered what will happen if -- what is the
9 effect here of separating out the Services? And I
10 find that -- now using the -- you know, my estimate
11 and the information I have on the -- on the more
12 relevant data, the up-to-date data, I find that the
13 share of revenue going to copyright holders goes up
14 now by about 18 percentage points, to about 67.

15 BY MR. SEMEL:

16 Q. And you mentioned earlier in discussing
17 your model that you thought it was conservative.
18 Can you explain what you mean by "conservative" in
19 this context?

20 A. Okay. So -- and why is it conservative?
21 Well, there's -- let me change that slide.

22 There's these --

23 Q. I just want to interrupt. Could you
24 first explain what you mean by "conservative"?

25 A. Okay.

1 Q. What does it mean?

2 A. By "conservative," I mean undervaluing
3 the copyright. Okay? So the numbers that you get
4 when you're looking at what the royalty rate is are
5 lower than what they would otherwise be if I weren't
6 considering it.

7 So I have -- there's four things, four
8 reasons, I think, that -- that make me think that
9 this is a conservative estimate.

10 JUDGE STRICKLER: Before you go into
11 that, Doctor, I just want to go back to the -- I
12 guess it was the previous demonstrative, assessing.
13 Yes, that's the one.

14 So you say at the end there, that you
15 believe that 29.1 percent of total interactive
16 streaming revenue should be allocated for musical
17 works.

18 If that were the case, do you -- is it
19 your opinion then that in the unregulated market for
20 sound recording royalties, that they would then be
21 reduced --

22 THE WITNESS: Absolutely.

23 JUDGE STRICKLER: -- to 70.9 percent or
24 thereabouts to make up the total pie of 100 percent?

25 THE WITNESS: So we're coming to that.

1 We're definitely coming to that.

2 JUDGE STRICKLER: That's revenue. So it
3 wouldn't be revenue --

4 THE WITNESS: So we're coming to that in
5 a -- in a slide or two, but --

6 JUDGE STRICKLER: We'll wait. We'll
7 wait.

8 THE WITNESS: We'll wait, okay. Okay.
9 We were talking about, I'm sorry, why possibly
10 this --

11 BY MR. SEMEL:

12 Q. Why do you use the word "conservative"?

13 A. Conservative. Well, first of all,
14 there's the issue of displaced revenues. The higher
15 is the revenue, the greater will be, you know, the
16 Shapley value for -- for the copyright holders.

17 And I haven't made any attempt myself
18 either to -- to try and estimate displaced revenues.
19 I think it's an exercise fraught with difficulty. I
20 didn't make any attempt to do that.

21 There's the issue there as well of the
22 costs that are involved, the cost overstatement.
23 The Shapley value or the Shapley model, what it
24 needs in there are the costs that generate the
25 total, sum total pool of revenues. And if there's

1 costs in there that all that does is shift consumers
2 from one service to another without changing the
3 total revenue.

4 It didn't generate a new revenue. So
5 it's not really a valid element of the -- of the
6 model. I didn't remove any of those costs either
7 myself, okay?

8 Thirdly, the -- the cost estimates that I
9 have used to try and look at how scale affects the
10 -- the non-content costs, what sort of economies of
11 scale there are here, is all based on the Spotify
12 costs, which were the ones that were made available
13 to me, but Spotify is, I don't know, what is it,
14 half of the industry or 45 percent, I think, or
15 something of the sort.

16 If -- if we had have used cost data from
17 bigger, more mature companies, you would expect
18 there to be a greater economy of scale effect in
19 there, and I didn't take that into account either
20 for not having any -- any information about that.

21 And I guess the final thing there is that
22 I retained from the original, Dr. Marx's original
23 model, that the sound recording and musical works
24 rightsholders are joined together and that removes
25 necessity from them artificially, rather than

1 actually valuing each separately. It would be
2 appropriate to separate them, but I just cannot
3 conceptually work out a model of that -- of that
4 size. It explodes and so I couldn't do it.

5 So that's the other area which make me
6 believe my results are conservative.

7 BY MR. SEMEL:

8 Q. And, finally, I think, getting --

9 JUDGE BARNETT: Excuse me. Dr. Watt --

10 THE WITNESS: Yes.

11 JUDGE BARNETT: -- you said that costs of
12 larger and more mature companies should have been
13 used, but in -- in the realm of interactive music
14 streaming, Spotify is kind of the granddaddy, not in
15 the U.S., but globally, Spotify has a more
16 impressive track record than any of the players that
17 are before us in this proceeding.

18 So why -- why do you think there would be
19 something better than Spotify?

20 THE WITNESS: Well -- okay. So what one
21 would expect under an economies of scale argument is
22 that the larger in general a firm gets, the smaller
23 in general would be the -- the costs that it needs
24 to -- to expend in order to, you know, to retain
25 itself. At least the smaller as a fraction of the

1 revenue that it's generating. So that's a scale
2 economy.

3 As I said, I didn't go into that. I have
4 no information on how that works in -- in this
5 particular industry. In -- in response, however, to
6 what you're -- what you're mentioning, it is true
7 that these bigger, more mature firms might be
8 younger in this space, but they are still great big
9 firms and they're able to accommodate -- there will
10 be some costs there that are used within this space
11 and yet that are also allowing them to operate in
12 other spaces. I don't know, for example, does
13 Google have a different building only for
14 interactive streaming as opposed to all of their
15 Google operations? These things I don't know.

16 But, you know, it's logical to think that
17 there's -- there's some element of scale economy in
18 such a massive firm that -- that will impact upon
19 the costs of revenues in this space alone.

20 JUDGE BARNETT: Thank you.

21 BY MR. SEMEL:

22 Q. So I think finally now, getting to some
23 of the questions you've been asked, did you do any
24 sensitivity analysis or checks with respect to
25 market outcomes?

1 A. Okay.

2 Q. And I want to just stop you here.

3 There's another blacked-out box here. So --

4 A. Yeah, I'll --

5 Q. -- please just don't talk about that.

6 A. I won't.

7 MR. SEMEL: And Your Honors can see it on
8 the paper. I don't think it needs elaboration.

9 THE WITNESS: Okay. So, yes, so the
10 answer is yes. I did this. And I was -- I was led
11 to doing this part of my report -- it's in -- you
12 know, I'm talking here of -- of the end section of
13 my Appendix 3.

14 Well, the first thing that you notice
15 when you look at Dr. Marx's numbers, and they're
16 starkly different from what you see in the market.
17 If I -- if I assume, and I think there's no reason
18 to assume too much otherwise, if there's no obvious
19 abuse of market power existing in the world, in this
20 space, you would kind of expect that the Shapley
21 model, at least ballpark, comes out, you know, close
22 to the -- the real-world setting.

23 So what is the element in the Shapley
24 model that -- that is different to the real world?
25 And that element is that one of the players here is

1 not actually subject to a statutory rate. That
2 player bargains a rate. And that's the sound
3 recordings.

4 So that leads me to believe that the
5 difference between the real-world outcomes and what
6 is derived, at least in -- in Dr. Marx's Shapley
7 analysis, may have -- may have something to do with
8 that. So I spend some time looking at that issue.
9 BY MR. SEMEL:

10 Q. And what did you conclude?

11 A. Okay. So, basically, when you run a
12 model with bargaining for that player and if you
13 hold the statutory rate fixed, which is the real
14 world, and then allow the other player to bargain,
15 what you have done is remove one of the essential
16 inputs from -- from the bargaining table, that
17 everyone can access at a given price.

18 This leaves the sound recording copyright
19 holders in a -- in a position of absolute power to
20 negotiate their rate. So the bargaining model that
21 I did shows that for every dollar that the statutory
22 rate holds down the musical works royalties, you
23 know, there's a -- there's an adjustment in the
24 bargained rate, one -- the lower is the statutory
25 rate, the higher will be, by 95 cents on the dollar,

1 the bargained rate.

2 So I'm aware that there -- that there are
3 direct deals expected around the margins of the
4 statutory rate by -- by the musical works holders,
5 but I think it's fair to say that they can't -- they
6 can't be reflective of a market bargaining rate.
7 They're still, you know, restricted to the -- by the
8 statute.

9 They only -- these direct deals would
10 only measure the statute and not measure a fair
11 allocation. So, I'm -- you know, I stick with the
12 bargaining model in which the reason why the sound
13 recording rate is so very high is because the
14 statutory rate is very low. And if you increase the
15 statutory rate, the bargained sound recording rate
16 will go down.

17 And this gets us back to your point, Your
18 Honor, that what's the ratio there? Well, the ratio
19 changes. As you change the statutory rate, the
20 ratio of one to the other changes. And so -- well,
21 that's -- that's the outcome of this -- of this
22 interplay.

23 JUDGE STRICKLER: Excuse me. So you
24 would predict, then, that if the rate that we were
25 to set were to be reflective of a Shapley-type

1 analysis as you've established in your critique
2 anyway of Dr. Marx, that in the negotiations in the
3 free market between interactive streaming services
4 and the labels, that that rate would decrease.

5 THE WITNESS: Absolutely. And I think
6 that the prediction or the model, what it's telling
7 me is that the sum total of the two stays almost the
8 same.

9 BY MR. SEMEL:

10 Q. So just getting back to a question that
11 -- that Judge Barnett had had earlier regarding the
12 D factor or the disruption factor.

13 A. True.

14 Q. How does this impact the --

15 A. So this answers this question. Because
16 when you change -- so what would disrupt this
17 industry is if the total sum amount of royalty
18 payments changes.

19 And it's because when I -- when I
20 increase one, I decrease the other almost dollar for
21 dollar, well, the total sum of royalties shouldn't
22 change. And so I should have, you know, a minimal
23 impact and not really be disruptive.

24 JUDGE STRICKLER: I understand your
25 testimony in that regard. What of the situation --

1 and I don't know if this is the factual situation --
2 that the -- the time period for existing agreements
3 between the -- the labels and the interactive
4 streamers is such that they've already locked in a
5 particular rate and then we set a rate that's higher
6 for the mechanical to reflect the fact that the
7 sound recording royalty should drop, but it's locked
8 in for a period of time? Are we running the risk,
9 then, of disrupting the market by having a total
10 royalty that's greater than what is indicated by
11 your Shapley testimony, simply because of the
12 disparity of times in which the rates are -- are
13 implemented?

14 THE WITNESS: That's a very fair point.
15 And I didn't even think of that until you've
16 mentioned it, but, you know, you would have -- I
17 would have to agree with you that -- so the model
18 that I have done is -- you know, is assuming that,
19 you know, you're able to -- that the -- that the
20 bargained thing happens at the same time as the --
21 or in the same general period of time as a change in
22 the statutory rate. You're absolutely correct.

23 JUDGE STRICKLER: And as an economist,
24 what would you think might be the result if -- if we
25 were to set mechanical rates based on the analysis

1 as you've described it so that they're higher
2 relative to --- than they are now, relative to the
3 sound recording rights? What is your opinion as to
4 what would happen to -- in terms of the bargaining
5 between the parties in the sound recording market,
6 interactive and labels, if the rates got too high?

7 That is to say, do you think there would
8 be renegotiation?

9 THE WITNESS: I do believe there would be
10 renegotiation. I have no knowledge of what the --
11 you know, how long those bargained rates are set in
12 stone for and when they're -- when they are able to
13 come up for renegotiation. But, of course, as soon
14 as that happens, the renegotiation would happen in
15 light of -- of a new environment with a different
16 statutory rate, and you would expect to see a
17 completely different bargaining outcome.

18 JUDGE STRICKLER: Well, but existing
19 agreements, wouldn't they only be renegotiated if
20 the Services simply were able to make a credible
21 case that they would have to shut down or
22 significantly reduce their operations so as to cause
23 reduction in the surplus even for the sound
24 recording -- for the labels, such that it would be
25 the labels' own interest to tear up the existing

1 agreements?

2 THE WITNESS: That could happen. I don't
3 know if it's -- you know, I'm not -- I'm not able to
4 comment on how, you know, how possible it is to take
5 an agreement that's in force and then change it.

6 JUDGE STRICKLER: That's another good
7 question.

8 THE WITNESS: But -- but certainly there
9 would be an element that -- that could happen if
10 that's feasible to do.

11 JUDGE STRICKLER: Given -- given the
12 potential problems of this overlapping time period,
13 do you think that the rate that would otherwise be
14 set here today should be -- if we were to adopt the
15 analysis that you're provided -- you've provided in
16 your testimony, should be implemented on an annual
17 basis with a step-up to eliminate or at least
18 mitigate the disruption?

19 THE WITNESS: That would certainly be an
20 option. It reminds me of, to be honest, the -- the
21 previous rate setting environment where I was
22 involved in general, where that was exactly the
23 case, that -- that to attempt to minimize
24 disruption, the rate was increased periodically over
25 a series of steps.

1 JUDGE STRICKLER: Thank you.

2 BY MR. SEMEL:

3 Q. Just one quick follow-up to clarify Judge
4 Strickler's questions. In your bargaining model,
5 did you take into account how the parties would --
6 might or were or were not addressing displacement of
7 revenues and -- and like? And does the bargaining
8 model address how the parties would react to a
9 displacement of revenues?

10 A. Yeah, the fact of the matter is I haven't
11 been able to do that, but what would -- what would I
12 expect occurs if there is revenue displacement?
13 That we know that revenue displacement, if we could
14 measure that, and if we could avoid that, it will
15 change what's coming out of a Shapley valuation of
16 the -- of the mechanical right. And so that, if
17 that is a reason to increase the -- the mechanical
18 royalty right, you would expect under this model
19 that the other comes down, 95 cents on the dollar.

20 JUDGE STRICKLER: Could we go back to the
21 -- the demonstrative that had the rings, the cost on
22 the outer rings. He has got control of that?

23 MR. SEMEL: Of the slides, yeah.

24 THE WITNESS: Which one? This one?

25 JUDGE STRICKLER: Let's go back to the

1 very first one of those. One more. Thank you,
2 Dr. Watt. So the costs are in the outer rings. I
3 think maybe my question may be applicable to the
4 displacement question. Do those -- are those
5 costs -- I understand they're non-content costs.

6 THE WITNESS: That's true.

7 JUDGE STRICKLER: Do they include or
8 exclude opportunity cost, that is, as it relates to
9 the -- to the Copyright Owners, their ability to
10 earn royalties from -- from other avenues of
11 distribution?

12 THE WITNESS: So these would have to be
13 financial costs because what we've got here is a
14 measurement of revenue, money dollars revenue, okay?
15 So to answer your question, the short answer is that
16 there are -- there is no opportunity costs built
17 into that disk.

18 JUDGE STRICKLER: Does Dr. Marx try to
19 build in opportunity costs when she adds in the
20 other players, the alternatives to streaming
21 services?

22 THE WITNESS: I don't recall.

23 JUDGE STRICKLER: But she does add in --
24 she adds in another player, doesn't she?

25 THE WITNESS: She does.

1 JUDGE STRICKLER: I mean, she does it for
2 that.

3 THE WITNESS: Yeah.

4 JUDGE STRICKLER: Those other players are
5 who?

6 THE WITNESS: I think it was the other
7 distributors of music, the non-interactive streaming
8 radios and sales of records and other things.

9 JUDGE STRICKLER: And you criticize her
10 adding that to the model?

11 THE WITNESS: Yeah, definitely. I mean,
12 I -- in the analysis that I've done, this is a point
13 that I hadn't brought up because I think it's far
14 less important to -- to what I've done than the
15 other points. If you have a -- if you have a player
16 in there who isn't subject really to this -- to this
17 proceeding and this hearing, you're going to
18 allocate a Shapley value to a player and that will
19 condition the Shapley values of all the other
20 players who really are relevant here.

21 So it will distort the valuation of all
22 the others. If I exclude that player, what effect
23 will that have on -- you know, what are -- which way
24 does that distortion work? Well, I don't know. And
25 there's really no way of telling unless you got into

1 that and -- and made that your only change, right?

2 I have no way of knowing whether that
3 additional player makes Shapley values go up or
4 down. All I know is it's a distortion that I don't
5 believe is needed or required in that model.

6 The model, all it's -- all it's going to
7 require is, you know, when players, that is, the
8 productive inputs or the Services, when they arrive
9 into a coalition, consumers come and go, right? You
10 know, their revenue grows. You don't really need to
11 have in the Shapley model itself a player who
12 supplies consumers to the interactive streaming
13 model and a player who absorbs consumers who leaves
14 it. All you need is consumers who come and go from
15 the model itself.

16 JUDGE STRICKLER: How -- with regard to
17 rate structure, how does -- let me ask it this way.

18 If the surplus is uncertain going
19 forward, how does -- how does that impact on the
20 structure of the rate, that is to say, per-play
21 versus percentage of revenue in the upstream market?

22 THE WITNESS: Well, I think we -- we
23 talked about that before. I mean, there's -- if
24 there is uncertainty in the model, and people are
25 risk averse, which I'm taking as being ubiquitous,

1 then you would want -- you would be better off
2 having a rate structure, for example, that avoids
3 uncertainty.

4 Now, there's always -- there's still
5 going to be uncertainty because you don't know -- if
6 you put, instead of a revenue sharing rate, a rate
7 on consumption, sorry, on numbers of consumers, you
8 know, you're guessing into the future how many
9 consumers there are, so at the present there's
10 uncertainty, but at least in every moment of time
11 you can count them. And there's no uncertainty
12 there about how much revenue there is or how much
13 the rate -- the payment should be; whereas if you
14 base it on an uncertain variable like revenue, it's
15 fraught with -- with difficulty.

16 JUDGE STRICKLER: Maybe I missed it,
17 maybe you had a separate exhibit, but I didn't see
18 in your report an identification of works relied on
19 or research or publications. First of all, let me
20 ask you that preliminary question.

21 Is there a separate document where you
22 say these are the --

23 THE WITNESS: Something was submitted,
24 right?

25 MR. SEMEL: I can actually say, in the --

1 in the binder exhibits you see, there was submitted
2 separately -- it's just the documents that are cited
3 in the -- in the report. So there is not a separate
4 appendix, other than one that was communicated to
5 counsel separately, but all that is is a compilation
6 of what you see literally cited in the report.

7 JUDGE STRICKLER: Okay. So my question
8 is this, and maybe you're not familiar with this. I
9 think -- I know it was cited in one of the other --
10 one or more of the experts' reports as a work, if
11 not relied on, reviewed.

12 The I think the economists who did it --
13 Mortimer is one and Spier is another. It relates to
14 the Blockbuster Video distribution method that they
15 had with regard to -- to movie chains.

16 And the analysis there -- and, again, if
17 this is not something that you're familiar with,
18 don't go forward, but the argument was that when
19 demand is uncertain downstream, there's some benefit
20 to having a percentage of revenue or revenue sharing
21 methodology upstream. Does --

22 THE WITNESS: As a -- as a risk-sharing
23 device, is that what the argument is?

24 JUDGE STRICKLER: As -- yes, as a revenue
25 sharing device upstream because of the uncertainty

1 of -- of rentals -- -

2 THE WITNESS: Yeah.

3 JUDGE STRICKLER: -- in the case
4 downstream.

5 First of all, before we get into it, are
6 you familiar with that research?

7 THE WITNESS: I -- this is Julie
8 Mortimer; am I right?

9 JUDGE STRICKLER: I think that's right.

10 THE WITNESS: I think -- I think I may
11 have seen this -- what you are talking about. Maybe
12 this is just a working paper or maybe this came out
13 as a book chapter or something of the sort.

14 I think I've seen it, but I don't -- I
15 haven't read that paper or analyzed it in any depth
16 by any means and certainly not recently.

17 JUDGE STRICKLER: It certainly didn't
18 inform your analysis one way or the other?

19 THE WITNESS: No, no. Absolutely no.

20 JUDGE STRICKLER: Thank you.

21 MR. SEMEL: Thank you. I have no further
22 questions at this time. I would like to -- there
23 are four exhibits that are -- were citations that
24 are referenced in his report that we'd like to admit
25 sort of in keeping with the practice here as

1 materials relied upon by the expert. And then there
2 are two Spotify-produced documents that we would
3 like to have admitted to the record. And I can give
4 you that.

5 JUDGE BARNETT: Start with the ones that
6 Dr. Watt relied upon.

7 MR. SEMEL: Correct. So 2679, 2697,
8 2724, and 2725. And, again, these are not admitted
9 for the truth, but these are things that were part
10 of what he relied upon.

11 JUDGE STRICKLER: Can I ask you a
12 question just before you go on? 2697, is that --
13 that's a -- the decision by Judge Cote in the rate
14 -- in the rate court?

15 MR. SEMEL: No. That is, I believe, the
16 testimony of Dr. Marx in that proceeding.

17 JUDGE STRICKLER: Okay. Do you -- does
18 Dr. Watt's report reference the specific pages for
19 us? And if not, do you have specific pages that you
20 want us to look at or you're suggesting we read the
21 entire --

22 MR. SEMEL: You might -- you might be
23 beyond what I can tell you right now. If you want,
24 I can look into that and tell you if there are
25 specific pages cited. I don't know that.

1 JUDGE STRICKLER: As you can imagine,
2 that might be quite the time saver.

3 MR. SEMEL: Understood. Absolutely. We
4 will take a look at that and find out if there are
5 specific pages. I would think that there are, but
6 I'll take a minute.

7 And then the other two are also cited in
8 his report, but we -- we want them admitted.
9 They're Spotify-produced documents.

10 JUDGE BARNETT: Okay. Let me hear about
11 the -- the four that we have.

12 MR. ASSMUS: Sure. If I can take them in
13 small pieces. 2679, there's no objection. There
14 are two articles, 2724 and 2725, which are press
15 reports on the mobile market. We object to those on
16 grounds of -- grounds of relevance. They have
17 nothing to do with interactive streaming. That's
18 2724 and 2725.

19 MR. SEMEL: If I may, I would just state
20 these deal with Spotify's price increases. So I
21 think they're certainly relevant -- again, they're
22 only being offered as things he relied upon to give
23 Your Honors context and not for the truth, but they
24 are most certainly, in our opinion, related to the
25 issues in this proceeding. They're Spotify's

1 interactive streaming price increases.

2 JUDGE BARNETT: Okay. And then for the
3 -- the fourth one?

4 MR. ASSMUS: Yeah, the fourth one, 2697,
5 is Dr. Marx's testimony in the Pandora ASCAP rate
6 court matter, which was the subject of a prior
7 ruling indicating that it was -- which I think was
8 used for impeachment. You did not allow it to come
9 in for evidence. For the reasons stated previously
10 both by me and Mr. Marks, who I see standing up, we
11 object to the -- the admission of the entire set of
12 -- the entire exhibit, which may be incomplete and
13 which, as you noted, may be cited just for one small
14 -- one small aspect of his report.

15 MR. SEMEL: And then --

16 JUDGE BARNETT: Thank you. Mr. Marks?

17 MR. MARKS: Yeah, I just wanted to lodge
18 Pandora's objection on the same grounds, to the
19 attempt to use the testimony as the second time.

20 JUDGE BARNETT: The full transcript of
21 the full hearing?

22 MR. MARKS: Exactly.

23 MR. ASSMUS: And if I could just respond
24 to Mr. Semel, and maybe I'm looking at the wrong
25 ones, but 2724 and 2725, I believe, are both about

1 mobile download rates and not -- not interactive
2 streaming.

3 MR. SEMEL: Are those about -- those are
4 about the mobile data plan? Yeah, again, these are
5 still about points that he makes that are related to
6 pricing changes. And, again, we're not putting them
7 in --

8 JUDGE STRICKLER: When you say he -- and
9 that he expressly identified in his report?

10 MR. SEMEL: Correct, correct.

11 JUDGE STRICKLER: By -- by name and by --
12 or by footnote, not by -- not just by description to
13 market.

14 MR. SEMEL: No, they were, in fact,
15 exhibits to his report. And they are about a page
16 long.

17 JUDGE BARNETT: And they were on the
18 demonstrative as well.

19 MR. SEMEL: I don't believe --

20 JUDGE BARNETT: This is -- this is
21 examples.

22 MR. SEMEL: Yes, yes. Exactly.

23 JUDGE BARNETT: They were. So 2679,
24 2724, and 2725 are admitted, not for the truth of
25 the matter but for -- as -- as documents upon which

1 this expert relied.

2 (Copyright Owners Exhibit Numbers 2679,
3 2724, and 2725 were marked and received into
4 evidence.)

5 JUDGE BARNETT: And with regard to the
6 transcript, I think the --

7 MR. SEMEL: Your Honor, if I may, you
8 know what, I will -- because as you correctly noted,
9 we did not put a page number in here. We'll
10 withdraw that now. I will note I believe we have
11 another witness who has identified some specific
12 page numbers. We may revisit this, but at this
13 point in time, I'll withdraw that.

14 JUDGE BARNETT: Thank you. And to the
15 extent you can share what -- what portions you want
16 to have admitted with counsel, then, you know, we
17 might eliminate the objections altogether, as long
18 as it's a limited portion and it's for a limited
19 purpose.

20 MR. SEMEL: Fully understood, Your Honor.

21 JUDGE BARNETT: You have two more or
22 three more?

23 MR. SEMEL: Oh, yes, I'm sorry. There
24 are two other documents that were Spotify documents.
25 They're -- did I give the numbers? No, 2764 and

1 Google Exhibit -- just because of the de-duping --
2 801. But both of these were produced by Spotify in
3 this proceeding and were related to the --

4 MR. ASSMUS: Your Honor, there's no
5 objection to 2764, which is an extract of Spotify's
6 financial database that was produced in discovery.
7 With respect to Exhibit 801, Mr. Semel is correct it
8 was produced by Spotify in this proceeding.
9 However, we don't believe there's any foundation for
10 that particular document.

11 In particular, it's not, for example, a
12 signed agreement between one of the parties and a --
13 and a label.

14 It's a PowerPoint presentation about a --
15 a potential bundling strategy, one that, indeed,
16 Mr. McCarthy might come across at some point. And
17 we don't believe that there's a basis, just because
18 it was produced from Spotify's files in this
19 litigation, that there's no obligation to lay a
20 foundation for the nature of that document, whether
21 it was implemented, et cetera. And that -- on that
22 basis, we object to admission of Exhibit 801.

23 JUDGE BARNETT: Thank you. Mr. Semel,
24 why is this appropriate?

25 MR. SEMEL: Why do we think it's

1 admissible? Yeah, well, I think one thing in this
2 proceeding, obviously, we don't have the ability to
3 summons 30(b)(6)'s to lay foundations for documents.
4 So they produced this. If their witnesses are going
5 to not give a it foundation, we don't believe,
6 because we don't have the ability to bring in
7 witnesses of our own to get foundations, that that
8 should be a limitation.

9 But it's also --

10 JUDGE STRICKLER: Did you take the
11 deposition of a witness who could have laid the
12 foundation?

13 MR. SEMEL: We took depositions of a
14 number of their witnesses.

15 JUDGE STRICKLER: Witnesses who could
16 have laid a foundation for these documents?

17 MR. SEMEL: We don't know, because --

18 JUDGE STRICKLER: Did you try?

19 MR. SEMEL: We did. We did raise this
20 document with a witness who didn't know about it,
21 and we can certainly question their witnesses, but,
22 again, it's produced by them.

23 JUDGE BARNETT: Well, foundation aside, I
24 think there's also a relevance objection. Can you
25 address that one?

1 MR. SEMEL: Absolutely. I mean, this is
2 their strategy for bundling their music subscription
3 with other products.

4 JUDGE BARNETT: Can you relate it to this
5 witness' testimony?

6 MR. SEMEL: Oh, yes, absolutely. He --
7 I'm sorry. He cites to this and it's an exhibit to
8 his testimony, if I can find it for you. He cites
9 specifically to it. If anybody finds it faster than
10 me.

11 Footnote 34 of his -- of his report, he
12 cites this in connection with his discussion of
13 revenue displacement and deferral and the problems
14 that you have with the Shapley model, kind of along
15 the lines of the slides you just saw, where you're
16 seeing revenue displacement and deferral. And then
17 this is an entire presentation that discusses that
18 strategy at Spotify. Again, to us this could not be
19 more essential to the proceeding.

20 MR. ASSMUS: Yeah, I think the -- the
21 cite that Mr. Semel -- highlights the problem here.
22 Mr. -- excuse me, Dr. Watts says this type of
23 bundling appears to be a business model Spotify
24 itself is now seeking to emulate. Divorced from the
25 foundation for that document, who created it? What

1 was it for? Were the plans carried out? We cannot
2 draw that conclusion from the document alone.

3 That's the purpose of the foundation rule so that
4 people aren't picking documents without any context
5 or foundation and making these types of assertions.

6 That's the basis for our objection. We
7 don't think the mere fact that an expert picks a
8 document, or maybe it's provided to him by counsel
9 out of a production, means that if they attach it to
10 the expert report, per se it's admissible.

11 JUDGE STRICKLER: Are you asking for it
12 to be admitted for the truth of the matter or just
13 because the witness relied on it?

14 MR. SEMEL: No, I think we're asking for
15 it to be admitted for your -- no, it will go to
16 weight.

17 JUDGE STRICKLER: How --

18 MR. SEMEL: Yes, we're asking --

19 JUDGE STRICKLER: Which one? I have this
20 choice there.

21 MR. SEMEL: Yes, we're asking for it to
22 be -- to be admitted without reservation --

23 JUDGE STRICKLER: No, no. Are you asking
24 for it to be admitted for the truth of the matter
25 asserted and that he relied on it, both?

1 MR. SEMEL: Well, I should -- no, because
2 I should clarify, because I don't think it needs to
3 be for the truth of the matter. So this is a
4 strategic document. We're not saying that they
5 carried this out. We don't even think it needs to
6 be carried out. So in that sense, the truth, I
7 don't think, is not what's necessary for this
8 document. The fact that they are considering this
9 is what is relevant, whether they carried it out or
10 not.

11 So, for example, he has talked did a
12 number of --

13 JUDGE BARNETT: I got your response.

14 MR. SEMEL: I'm sorry. I don't think it
15 needs to be admitted -- I should say, I don't think
16 it needs to be admitted for the truth that
17 everything in here took place because that's not
18 what we're saying. This is an internal document
19 that considers business plans, and that's all we're
20 asking for it to be admitted for.

21 For example, there's a big premium
22 bundle. No one is saying they did that. But we are
23 saying they considered that. And so that's
24 relevant.

25 JUDGE BARNETT: And so that's your

1 argument, okay.

2 MR. SEMEL: Yes.

3 JUDGE BARNETT: And so this exhibit is
4 admitted not for the truth of the matter asserted
5 therein and the lack of foundation certainly --
6 because this witness relied on it and cited it, and
7 the -- the foundation for its admission goes to its
8 weight in this circumstance. It's not being
9 admitted for the truth in any event. Okay?

10 (Google Exhibit Number 801 was marked and
11 received into evidence.)

12 JUDGE BARNETT: So we will be at recess
13 until 1:15.

14 MR. SEMEL: I'm sorry, I don't know if
15 that was actually put on the record. They had no
16 objection to 2764. I don't know if that was
17 officially admitted or not.

18 JUDGE BARNETT: I think I forgot. It is.

19 (Copyright Owners Exhibit Number 2764 was
20 marked and received into evidence.)

21 (Whereupon, at 12:16 p.m., a lunch recess
22 was taken.)

23

24

25

1 AFTERNOON SESSION

2 (1:23 p.m.)

3 JUDGE BARNETT: Please be seated. It is
4 nice to be back. Judge Feder has a question for the
5 witness, which while we're waiting for things to
6 progress, maybe we can go ahead and ask.

7 JUDGE FEDER: Good afternoon, Dr. Watt.

8 THE WITNESS: Good afternoon.

9 JUDGE FEDER: If I understand your report
10 correctly, you used the Shapley analysis first to
11 divide out the content costs, that sound recordings
12 for publishers royalties, to determine that element.

13 And then in your subsequent analysis, you
14 divide up sound recording from publishers. Is that
15 it roughly speaking?

16 THE WITNESS: Roughly speaking, I know
17 what you are talking about.

18 JUDGE FEDER: Okay. As far as I
19 understand your report, though, you are looking at
20 the publishers' royalties as a unit, not as -- not
21 looking at the separate elements of performance
22 royalties and mechanical royalties?

23 THE WITNESS: Correct.

24 JUDGE FEDER: Do you factor that into
25 your analysis in any way or is your -- does your

1 analysis basically stop once you have separated out
2 the publishers' share?

3 THE WITNESS: Yes, so the second is true.
4 Is that working? I think so.

5 What I have done was to follow Dr. Marx's
6 report and, from the baseline model, in finding a
7 share of revenue that would correspond to all of the
8 copyright holders together.

9 And then in a second analysis, see how
10 one might imagine that could be split between
11 publishers, and so that musical works and the sound
12 recordings, but I didn't further subdivide musical
13 works.

14 JUDGE FEDER: So one of the -- one of the
15 questions that we're being asked to look at is
16 whether the mechanical royalty should be set as an
17 all-in royalty; in other words, the performance
18 royalties get subtracted from that in the final
19 calculation as opposed to a mechanical royalty being
20 just a mechanical royalty and that's on top of
21 whatever the Services have to pay to the performing
22 rights organizations.

23 So is it fair to say that your analysis
24 is not informative on that particular question?

25 THE WITNESS: Yeah, that's true.

1 JUDGE FEDER: Okay. Thank you.

2 JUDGE BARNETT: Mr. Assmus?

3 MR. ASSMUS: Yes. Thank you.

4 JUDGE BARNETT: I was beginning to wonder
5 if we were just supposed to do this by ourselves.

6 MR. ASSMUS: You are doing a great job of
7 it.

8 JUDGE BARNETT: Thank you.

9 CROSS-EXAMINATION

10 BY MR. ASSMUS:

11 Q. Good afternoon, Dr. Watt.

12 A. Good afternoon.

13 Q. We met at your deposition, correct?

14 A. Indeed we did.

15 Q. I wanted to start with a point of
16 clarification on a question that Judge Strickler
17 asked you. And, in fact, it follows up on Judge
18 Feder's questions as well.

19 Based on your analysis you determine a
20 total share of revenue to be allocated to both the
21 musical works and sound recording rightsholders of
22 67 percent of revenue, correct?

23 A. That's correct.

24 Q. And there was some, a question and answer
25 about what fraction of that you believe should go to

1 the publishers. And that fraction is 43.5 percent,
2 correct?

3 A. That's correct.

4 Q. And that leads to, just by pure
5 mathematics, a musical works royalty of 29.1 percent
6 of revenue, correct?

7 A. Correct.

8 Q. And you understand that the current
9 headline all-in rate is 10.5 percent of revenue,
10 correct?

11 A. I understand, sir.

12 Q. And so what you are advocating here,
13 correct me if I am wrong, is roughly a tripling of
14 the musical works royalty, correct?

15 A. I think advocating is a strong word. I'm
16 just reporting the results of the model.

17 Q. But the results of the model you have
18 constructed in your view suggest a tripling of the
19 mechanical -- excuse me, the musical works royalty?

20 A. The results of the model suggest that.

21 Q. Now, you understand that the royalty rate
22 set here should satisfy the 801(b) factors, correct?

23 A. Correct.

24 Q. And you are familiar with factor A,
25 maximizing availability of creative works to the

1 public?

2 A. Yes.

3 Q. And you understand that Dr. Marx equates
4 factor A to total consumer and producer surplus,
5 correct?

6 A. Correct.

7 Q. But in your view total surplus equates to
8 the actual use of the copyrighted works, not their
9 availabilities; am I understanding you correctly?

10 A. Yes.

11 Q. And instead you, in factor A, is
12 suggesting that songwriters need to have the correct
13 incentive to continue to create compositions; is
14 that right?

15 A. That's correct.

16 Q. And in your view availability is
17 maximized if there are lots of inventory of creative
18 works available for sale, even if no one was buying
19 them?

20 A. That's availability, yes.

21 Q. So, in other words, the availability --
22 the ability of consumers to access musical works is
23 not in your view a function of price, correct?

24 A. Can you repeat that?

25 Q. Sure. In your view the ability of

1 consumers to access musical works is not a function
2 of price, correct?

3 A. I'm not sure I would agree entirely,
4 totally with that. You have used now the word
5 access rather than availability.

6 Q. Let me put it this way. The availability
7 of musical works is not a function of price,
8 necessarily?

9 A. Not necessarily, yes, I think I would
10 agree with that.

11 Q. And we will get to your Shapley value in
12 a bit, but your Shapley value model doesn't tell you
13 anything about consumer welfare; is that correct?

14 A. No, it doesn't.

15 Q. Now, using your definition of
16 availability, you haven't seen any evidence that
17 there is an undersupply of songs, have you?

18 A. I have not looked at that.

19 Q. You haven't seen any evidence to the
20 contrary?

21 A. No.

22 Q. And you also haven't seen any evidence
23 that the current rates aren't properly incentivizing
24 songwriters, have you?

25 A. The closest I could say that I have come

1 to seeing something like that was the witness that I
2 saw before me.

3 Q. Mr. Bogard?

4 A. Yes. That's the closest I have come.
5 But when I prepared my reports, no.

6 Q. Now, Dr. Watt, did you understand Dr.
7 Marx to be claiming that Services are welfare
8 maximizers and not profit maximizers?

9 A. I did understand that that was the
10 message from the -- from the analysis that Dr. Marx
11 has offered in respect of the rate structure.

12 Q. In your view she has not modeled the
13 Services as profit maximizers?

14 A. Well, she has -- there isn't an analysis
15 in that section of her report as far as I recall of
16 firms -- of the way firms operate, but there is an
17 analysis in that section of the report on how
18 welfare or efficiency would respond to the copyright
19 rate for the input.

20 Q. But in her Shapley value model, she has
21 modeled the Services as profit maximizers, correct?

22 A. In the Shapley, you are going back to
23 Shapley now?

24 Q. Yes.

25 A. Well, so the Shapley model doesn't --

1 neither in her model nor in any Shapley model, that
2 is not -- there is no element in there of profit
3 maximization strategies at all. What there is is a
4 created surplus and it is how that is shared.

5 One would have to assume, I suppose, that
6 there is an incentive there that created the surplus
7 that is created, be as large as possible, which is a
8 profit maximization idea, but that's not the essence
9 of that model.

10 Q. You acknowledge that Dr. Marx views the
11 Services as profit maximizers, correct?

12 A. I think she does, yes.

13 Q. Do you think that royalties set in this
14 proceeding will affect consumer welfare?

15 A. Well, that's where I don't know. I don't
16 know how, you know, how the relationship will be at
17 the end of the day between the rates that are set
18 and what happens later in the output market.

19 Q. And you haven't, therefore, analyzed
20 consumer welfare in your report?

21 A. Only to the extent that I have discussed
22 the Marx conclusions.

23 Q. And do you believe that royalties set in
24 this proceeding will affect total welfare?

25 A. Well, it is the same question. I don't

1 think -- I haven't analyzed that because I'm unaware
2 and I am not able to comment on the pass-through
3 that happens through the Services of the royalty
4 rate amount or structure, how that passes through
5 and how that impacts upon their pricing decisions.

6 Q. You haven't analyzed that?

7 A. I haven't analyzed that.

8 Q. So there is, I think, two parts to your
9 report; one on efficiency and one on Shapley value.
10 Do I have that about right?

11 A. You have that right.

12 Q. I would like to take Shapley first. As
13 part of your work in this proceeding you conducted
14 several Shapley value analyses, correct?

15 A. Well, I conducted -- okay. I conducted,
16 I suppose you are right, several. I repeat, did a
17 replication of Dr. Marx's model itself. That's a
18 Shapley analysis.

19 And I performed what I call a corrected
20 methodologically corrected Shapley analysis. I also
21 included a Shapley sharing structure to work out
22 what -- how that 67 percent might be shared between
23 the other two. So I think it is correct to say that
24 there are several.

25 Q. And you believe that the Shapley approach

1 is the correct methodology for finding a rate that
2 satisfies factors B and C of the 801(b) standard; is
3 that correct?

4 A. That's true.

5 Q. Now, the Shapley value method itself does
6 not counsel against the percentage-of-revenue
7 royalty, does it?

8 A. The Shapley value itself shares value,
9 how you make that happen, how you instrumentize that
10 is not, is not dealt with by the model.

11 Q. Doesn't tell you one way or the other?

12 A. Doesn't tell you.

13 Q. And Shapley value can be useful generally
14 in rate-setting proceedings, correct?

15 A. Generally.

16 Q. You mentioned that you were happy one is
17 being considered here?

18 A. Yes.

19 Q. And, in fact, you performed a Shapley
20 value analysis in connection with testimony before
21 the New Zealand copyright tribunal, correct?

22 A. I did.

23 Q. It is mentioned in paragraph 2 of your
24 report?

25 A. Yes.

1 Q. And in that matter you are engaged by
2 Phonographic Performances New Zealand Limited?

3 A. I was.

4 Q. And that's a collective of copyright
5 holders?

6 A. Yes.

7 Q. And that proceeding was to set a
8 statutory rate for terrestrial radio, correct?

9 A. That's correct.

10 Q. And you understood that the standard
11 applied in the New Zealand proceeding to be similar
12 to the one applied in this proceeding?

13 A. Yes.

14 Q. If we could take a look at Trial Exhibit
15 Number 1695. It should be in your book.

16 A. Is it in one of these binders?

17 Q. It is in one of those binders. Yes, I
18 believe it will be the first one.

19 JUDGE STRICKLER: Are these cross
20 binders?

21 MR. ASSMUS: They are cross binders. Do
22 you have them, Your Honor?

23 JUDGE STRICKLER: What was that number
24 again?

25 MR. ASSMUS: 1695.

1 BY MR. ASSMUS:

2 Q. Dr. Watt, did you find it?

3 A. Yes, I did.

4 Q. Do you recognize this document?

5 A. I do.

6 Q. And what is it?

7 A. I believe that it is the decision, the
8 published decision from that Court case.

9 MR. ASSMUS: Your Honor, I'd move for
10 admission of Trial Exhibit 1695.

11 MR. SEMEL: I think first I would like to
12 see a foundation for why a New Zealand decision is
13 relevant to these proceedings.

14 JUDGE BARNETT: That objection is
15 sustained, even though it wasn't phrased as an
16 objection.

17 MR. SEMEL: I apologize.

18 BY MR. ASSMUS:

19 Q. I will try to lay that foundation, Your
20 Honor.

21 Dr. Watt, you testified before that New
22 Zealand copyright tribunal in connection with this
23 matter, correct?

24 A. That's true.

25 Q. And you referenced that work in

1 connection with your written rebuttal report,
2 correct?

3 A. I mentioned it as an experience that I
4 had.

5 Q. And you, in fact, used a Shapley value
6 analysis to conduct your analysis in that
7 proceeding, correct?

8 A. Yes, that's correct.

9 MR. ASSMUS: Your Honor, I would renew
10 the motion to admit Trial Exhibit 1695, on the basis
11 that this was referenced in his written rebuttal
12 testimony, he performed a Shapley value analysis in
13 a rate-setting proceeding, he mentioned several
14 times on direct that there is an analogy to this
15 proceeding.

16 MR. SEMEL: I object. My issue is just
17 this is the written decision. It is not his
18 analysis. It is like 100 pages. I just don't know
19 why we're putting this in the record.

20 Maybe he wants to find out what part of
21 this is relevant to the proceeding. I just don't
22 understand. This is not Dr. Watt's work. This is a
23 decision.

24 JUDGE BARNETT: We normally don't look to
25 foreign authorities in making our decisions. So

1 sustained, Mr. Semel.

2 If you want to dig further, you may.

3 MR. ASSMUS: Sure. I will do it largely
4 as impeachment, Your Honor. I am offering it not
5 for the decision itself but just to the extent it
6 illustrates the Shapley value analysis that Dr. Watt
7 did in that proceeding.

8 JUDGE BARNETT: All right. If you can
9 narrow it down.

10 BY MR. ASSMUS:

11 Q. You have written papers, in fact, about
12 Shapley value's use in rate-setting proceedings,
13 correct?

14 A. I'm not sure that's correct. I have
15 written papers on the Shapley value for, you know,
16 for looking at how copyright might be remunerated,
17 but not necessarily reference to rate-setting
18 procedures.

19 Q. And one of the reasons Shapley values can
20 be useful is that they can be used to determine fair
21 rates, even when the market rates are set by a
22 monopolist, correct?

23 A. Correct.

24 Q. And a rate set in the market might
25 reflect monopoly power?

1 A. Well, a rate set in the market might
2 reflect that, and it might reflect abuse of monopoly
3 power.

4 Q. Or it might reflect other forms of market
5 power, correct?

6 A. It might reflect, yes.

7 Q. And in those instances the market rate
8 might not reflect a fair rate, correct?

9 A. Correct.

10 Q. So I want to turn to one of the articles,
11 which is Spotify Exhibit -- excuse me, Trial Exhibit
12 1713, which should also be in your binder.

13 JUDGE STRICKLER: What was the exhibit
14 number?

15 MR. ASSMUS: 1713.

16 BY MR. ASSMUS:

17 Q. Do you have it in front of you?

18 A. Yes, I do.

19 Q. And do you recognize this document?

20 A. I do.

21 Q. And what is it?

22 A. Well, the cover, the first page is the
23 cover of a -- it is the text -- it is a book that I
24 worked on. And this is one of the chapters out.

25 Q. It is called the Handbook on the

1 Economics of Copyright?

2 A. Yes.

3 Q. And you edited this volume?

4 A. I did.

5 Q. And did you, in fact, author Chapter 7?

6 A. Yes.

7 Q. Entitled Fair Remuneration For Copyright
8 Holders and the Shapley Value?

9 A. Indeed.

10 MR. ASSMUS: Your Honor, I move for
11 admission of Trial Exhibit 1713.

12 MR. SEMEL: I guess I don't know about
13 why we're putting in -- I don't know if I have an
14 objection to putting in the witness' work, but is he
15 going to try to impeach? Is this an impeachment
16 exhibit or are we putting in papers he has written?
17 I just am not really sure where we're going with
18 this.

19 MR. ASSMUS: I will get to the substance.
20 I didn't want to get to the substance until I asked
21 it admitted.

22 It is relevant, Your Honor, because it is
23 Mr. Watt's academic work on the Shapley value method
24 that he applied in this proceeding.

25 JUDGE BARNETT: Okay. Is there some

1 reason we need to see that as opposed to accepting
2 his testimony here?

3 MR. ASSMUS: I will get there, Your
4 Honor. I will get there.

5 JUDGE BARNETT: All right. I will give
6 you a little leeway.

7 MR. ASSMUS: Thank you.

8 BY MR. ASSMUS:

9 Q. And this Chapter 7 is an exposition of
10 the use of Shapley value models to determine fair
11 rates, correct?

12 A. It is a discussion of the Shapley value
13 model.

14 Q. And this particular paper related to
15 setting rates for radio, correct?

16 A. I think that was the example used in this
17 paper.

18 Q. And is it your view that radio broadcasts
19 are an item of significant social value?

20 A. I do.

21 Q. And, in fact, if a profit maximizing
22 copyright holder was a monopolist, that might
23 endanger the socially optimal level of radio
24 broadcasting, correct?

25 A. In an unregulated environment?

1 Q. Yes.

2 A. I don't think it would endanger the
3 broadcast because the copyright holder would have
4 every incentive that the broadcast goes ahead.

5 Q. But it might endanger the socially
6 optimal level of broadcasting?

7 A. Well, I don't believe so, no. I believe
8 here the radio goes here or it doesn't. It is a
9 binary example. I don't think that the radio would
10 go ahead half or something like that.

11 Q. If you could take a look at the third
12 sentence of that Chapter 7, tell me if I read it
13 right, "In particular, in many countries radio
14 broadcasts of music are seen to be a service of
15 significant social value and" --

16 JUDGE BARNETT: Would you slow down your
17 reading?

18 MR. ASSMUS: Thank you.

19 BY MR. ASSMUS:

20 Q. "In particular, in many countries radio
21 broadcasts of music are seen to be a service of
22 significant social value, and it is thought that a
23 profit maximizing license fee set by copyright
24 holders in the music might endanger the socially
25 optimal level of radio broadcasting." I read that

1 correctly?

2 A. I think you did.

3 Q. And that was the view you stated in this
4 paper?

5 A. Yes.

6 Q. And then it is correct, isn't it, that
7 one objective of a Shapley value analysis is to
8 attempt to find a tariff, that while still offering
9 fair recompense to the copyright holders, is also a
10 fair measure of the value of the music to radio
11 broadcasters, correct?

12 A. Correct.

13 Q. And the work you did in this chapter
14 related to the use of Shapley value to address that
15 potential market imperfections, correct?

16 A. Well, as I recall, because -- so as I
17 recall, this chapter, what it does or what I was
18 doing was writing an exposition that was accessible
19 to students and teachers. So just playing out and
20 showing what the Shapley methodology does and how it
21 works and how it might be applied to a specific
22 case, which was a chosen case here is radio.

23 Q. And in this case the use of the Shapley
24 methodology would allow you to remove any monopoly
25 power that the copyright holders may hold, correct?

1 A. Not correct.

2 Q. Okay. If you could take a look at page
3 127 of the paper in the conclusion section. The
4 last full sentence of the first paragraph in the
5 conclusions, "The use of the Shapley methodology
6 allows us to remove any monopoly power that the
7 copyright holders may otherwise hold, when they
8 combine as a single bargaining unit under a
9 copyright collective."

10 Have I read that correctly?

11 A. Yes, you did.

12 Q. And you -- you agree with that conclusion
13 in the paper?

14 A. So the -- what this sentence that you
15 have read out is implying is that if the copyright
16 holders join together, then they may abuse this
17 market power by fact of joining together or being
18 joined together for reasons of economic efficiency,
19 of running the collective floor for the copyright.

20 So in order to counter for the possible
21 abuse, that is what the Shapley methodology is
22 eliminating. Okay?

23 Q. So the Shapley value methodology is a way
24 to counter the potential monopoly power of the
25 players?

1 A. The potential abuse of the monopoly
2 power.

3 JUDGE STRICKLER: The sentence that you
4 read doesn't refer to abuse of power.

5 THE WITNESS: No, it is true. It is
6 poorly worded. I said that.

7 JUDGE STRICKLER: Thank you.

8 MR. ASSMUS: Your Honor, I would like to
9 renew my motion to admit Spotify Exhibit 1713, which
10 is Chapter 7 we have just been discussing?

11 JUDGE BARNETT: For what purpose?

12 MR. ASSMUS: For the purpose of
13 indicating Dr. Watt's views on the Shapley value
14 analysis that he used in this proceeding.

15 MR. SEMEL: I would object to it. The
16 issue I have, Your Honor, is just that these -- it
17 is not impeaching anything that is in his testimony.
18 He is bringing up old papers and questioning about
19 what's in the paper, but there has been no
20 connection to anything that's in his rebuttal
21 testimony.

22 I don't see --

23 JUDGE BARNETT: Sustained.

24 MR. SEMEL: -- a problem with this, but I
25 just don't know why we're talking about it.

1 JUDGE BARNETT: Sustained.

2 BY MR. ASSMUS:

3 Q. Now, part of your assignment in this
4 matter was to evaluate Dr. Marx's Shapley value
5 methods, correct?

6 A. Yes.

7 Q. And you understand she constructed two
8 models, correct?

9 A. Yes, I believe there were two models.

10 Q. A baseline model with one upstream
11 player?

12 A. Um-hum.

13 Q. And you criticized this baseline model as
14 not providing a division of surplus between sound
15 recording rightsholders and musical works
16 rightsholders?

17 A. I mentioned it, yes.

18 Q. But Dr. Marx constructed an alternative
19 model with two upstream players, correct?

20 A. Correct.

21 Q. One representing labels and one
22 representing publishers?

23 A. That is correct.

24 Q. Sorry, you have to answer verbally.

25 A. Sorry.

1 Q. And that model does allow derivation of
2 the revenue royalties between labels and publishers?

3 A. Yes, it does.

4 Q. I would like to focus on that alternative
5 model. Now, you testified on direct regarding -- to
6 construct a Shapley value model you need to identify
7 the players in the model, correct?

8 A. That's correct.

9 Q. And once those players have been
10 identified, you need to perform the Shapley value
11 calculations, you need data on revenue and costs for
12 each player, correct?

13 A. That's correct.

14 Q. And one of your criticisms of Dr. Marx is
15 based on the data she used in her Shapley value
16 models, correct?

17 A. That's correct.

18 Q. In fact, you suggest that she didn't use
19 "real numbers," correct?

20 A. Yeah, real being numbers that reflect the
21 reality, the current reality.

22 Q. The number of -- there are a number of
23 aspects to that criticism of her number, correct?

24 A. Yes.

25 Q. For one you suggested that the Shapley

1 value analysis should take into account the "value
2 of expected future earnings"?

3 A. Yes.

4 Q. That's not something that companies
5 regularly report, is it?

6 A. Well, it is tied into their stock value,
7 so I am not sure if they report it or not, but it is
8 -- it is -- it is fairly easy for them to calculate
9 and to estimate.

10 Q. And what about companies that do not have
11 a stock value?

12 A. Well, I'm sure that the owners are aware
13 of what their stock values are. That they reported,
14 a non-listed company? I wouldn't know. But I'm
15 sure it is something they are aware of.

16 Q. And did you calculate the value of
17 expected future earnings for any of the Shapley --
18 the players in your Shapley model?

19 A. Not at all. I was trying to do a direct
20 replication.

21 Q. And, in fact, that's not something that
22 you really could do, is it?

23 A. No, it is not.

24 Q. And you didn't use the concept of
25 expected future earnings in your New Zealand Shapley

1 value analysis, did you?

2 A. Stretching my memory there, but I believe
3 not.

4 Q. Another criticism you make of Dr. Marx is
5 she did not exclude comparative advertising costs,
6 correct?

7 A. Correct.

8 Q. And by comparative advertising, you mean,
9 for example, a Spotify ad suggesting it is a
10 superior service to Pandora?

11 A. Yeah, competitive was I think the word we
12 used.

13 Q. Competitive. And it could be the
14 opposite too, Pandora suggesting its better service
15 than Spotify. A competitive ad can act as a form of
16 general advertising, can't it?

17 A. It can.

18 Q. A consumer that saw a competitive ad and
19 was not a consumer of either service might decide to
20 try interactive streaming, correct?

21 A. That's true.

22 Q. And that might expand the market for
23 interactive streaming?

24 A. That's true.

25 Q. If you were to exclude such costs in a

1 Shapley model, you would want to do it
2 symmetrically, in other words, upstream and
3 downstream, correct?

4 A. Sorry, which upstream competitive
5 advertising are you talking of?

6 Q. Well, for example, a record label might
7 advertise competitively against another?

8 A. I presume so.

9 Q. And if that was the case, you would want
10 to exclude that from the upstream costs as well?

11 A. At the end I didn't exclude any of those
12 costs. That's where you are heading, I didn't -- I
13 have mentioned that that's one of the reasons why my
14 estimates are conservative and, indeed, probably it
15 is another reason why we should understand Dr.
16 Marx's estimates as conservative.

17 Q. But if you were to exclude such costs,
18 you would want to exclude it both on the upstream
19 and the downstream side?

20 A. Yes.

21 Q. And in your New Zealand analysis, you
22 didn't exclude competitive advertising costs, did
23 you?

24 A. Again, I really can't recall how that was
25 done.

1 Q. You also fault Dr. Marx for including
2 executive bonuses in her cost calculations, correct?

3 A. So I think that was mentioned as one more
4 possibility that might be interfering with the
5 model.

6 Q. And if you excluded those costs, you
7 would want to again do it both from the upstream and
8 the downstream side, correct?

9 A. Presumably.

10 Q. Labels and publisher executives may
11 receive bonuses as well, correct?

12 A. Correct.

13 Q. And in your New Zealand analysis, you did
14 not exclude executive bonuses, correct?

15 A. We didn't, as I recall, make any
16 exclusion for that, and I don't know if there were
17 any such bonuses.

18 Q. You didn't ask about that --

19 A. No.

20 Q. -- in doing your New Zealand Shapley
21 value calculations?

22 A. No, no.

23 Q. You also fault Dr. Marx for not using
24 what you view as the most up-to-date data, correct?

25 A. Correct.

1 Q. And you note in your report that data was
2 available through the half, halfway through 2016,
3 correct?

4 A. That's correct.

5 Q. But -- and you used up-to-date revenue
6 figures, correct?

7 A. When I did the -- yeah, the replication,
8 sure.

9 Q. But you did not use up-to-date cost
10 figures, correct?

11 A. I did my best to.

12 Q. You made projections of costs based on
13 assumptions you made?

14 A. Based on assumptions and on some real
15 data that was provided to me.

16 Q. And the assumptions you made were based
17 on a projected percentage of non-content costs --
18 excuse me -- based on non-content costs as a
19 percentage of revenue, correct?

20 A. Yes.

21 Q. And isn't it true that projected costs
22 are less reliable than actual costs?

23 A. If you don't have the actual costs, the
24 estimates are as good as you will get. So the fact
25 of the matter is that some -- that the trend, I

1 suppose, let's say, was obvious from actual data,
2 and carrying that forward you get a very crisp
3 estimate of what the situation might look like going
4 forward.

5 Q. And are you aware of whether Spotify's
6 actual costs were available through the midpoint in
7 2016?

8 A. I can't remember the exact final data
9 point that was given to me in actual costs. I don't
10 recall that, so I can't really answer.

11 Q. But if you -- if you had it, you didn't
12 use it, correct?

13 A. If I had it, I did use it. If I didn't
14 have it, I didn't.

15 Q. But I think you confirmed earlier you did
16 not use actual costs, you used projections, correct?

17 A. Well, I used the actual costs up to the
18 point where they were made available to me, up to
19 the date at which they were made available to me,
20 which I don't recall what it was.

21 Q. And your analysis went up through the
22 midpoint of 2016, correct?

23 A. Yeah, I used the revenue data up to the
24 midpoint of 2016.

25 Q. But the cost data that you had available

1 to you did not go through the midpoint of 2016?

2 A. I don't recall exactly when -- what was
3 the last date of actual data as opposed to projected
4 data.

5 Q. I take it then you did not compare the
6 projections you used to Spotify's actual costs
7 through the midpoint of 2016?

8 A. I haven't seen any further data to do
9 that.

10 Q. You haven't asked to see further data on
11 that?

12 A. No, no.

13 Q. Now, you also fault Dr. Marx for
14 allocating some of Spotify's global costs to its
15 U.S. operations, correct?

16 A. I think that was also mentioned.

17 Q. And you understand Dr. Marx used the
18 allocation that Spotify reports internally, correct?

19 JUDGE STRICKLER: You mean the allocation
20 between U.S. and worldwide?

21 MR. ASSMUS: Correct.

22 BY MR. ASSMUS:

23 Q. Correct.

24 A. I think so, yes.

25 Q. And you understand that a global parent

1 company may perform services for one of its U.S.
2 affiliates, correct?

3 A. That's correct.

4 Q. For example, a global parent may perform
5 HR functions?

6 A. That's correct.

7 Q. And in those cases where it is performing
8 those functions for its affiliate, it would be
9 proper to include those costs in the Shapley value
10 calculation for the U.S. entity, correct?

11 A. So it would be appropriate to include
12 costs as they relate to the revenue, the revenue
13 that is generated by the usage. So to the extent
14 that you can establish which of the overhead costs
15 are actually related to the usage of music and would
16 be relevant to include them, and to the extent that
17 it is simply a number, a part of the revenue that's
18 extracted away into the parent company, then it
19 shouldn't be included.

20 Q. You didn't object to the concept in
21 general of allocating some measure of a parent
22 company's global cost to the U.S. business?

23 A. True.

24 Q. But you take issue with the way Spotify
25 allocates those global costs to the U.S. market?

1 A. Well, it was mentioned as one factor that
2 might be happening.

3 Q. And in particular you were concerned that
4 Spotify's over-allocating global costs to the U.S.
5 market?

6 A. Yes.

7 Q. Now, Spotify's costs in the U.S. will
8 depend in part on its market position in the United
9 States, correct?

10 A. Yes.

11 Q. Including the level of competition in
12 that market?

13 A. Yes.

14 Q. And its global costs will depend on the
15 same factors outside the United States?

16 A. Yes.

17 Q. And outside the U.S., you don't know how
18 long Spotify has been in business, do you?

19 A. No.

20 Q. And you don't know the state of
21 competition for Spotify outside the U.S., correct?

22 A. I don't.

23 Q. Now, in addition to the data issue, the
24 data criticisms you levy on Dr. Marx's report, you
25 also fault the way she constructed the players in

1 her model?

2 A. That's true.

3 Q. You fault, for example -- strike that.

4 Dr. Marx's alternative model has four
5 players, correct?

6 A. I can't recall. I think it had two input
7 suppliers and two output.

8 Q. Right, two upstream suppliers --

9 A. True.

10 Q. -- labels and publishers?

11 A. Yes.

12 Q. Two downstream suppliers, correct?

13 A. One of which was interactive streaming
14 and one was others. Is that so?

15 Q. Yes. And in the real world, labels and
16 publishers have multiple distribution channels to
17 choose from, correct?

18 A. I suppose. I am not an expert on how
19 that distribution happens, but I observe that there
20 are multiple distribution channels.

21 Q. You understand that interactive streaming
22 is not the only distribution channel?

23 A. Yeah, true.

24 Q. So the other distribution channel exists
25 in the marketplace that Dr. Marx was attempting to

1 model, correct?

2 A. You are talking about the player called

3 other distributors?

4 Q. Yes.

5 A. It exists in the parallel space.

6 Q. In other words, in the real world?

7 A. Yeah, but outside of the interactive

8 streaming space.

9 Q. Now, you also fault Dr. Marx for modeling

10 a single interactive streaming player, correct?

11 A. I do.

12 Q. Instead, you modeled three interactive

13 service --

14 A. That's true.

15 Q. -- companies, correct? And you modeled

16 those three downstream players against a single

17 copyright owner, correct?

18 A. That's correct.

19 Q. So essentially you modeled an upstream

20 monopolist against three competitive downstream

21 firms, correct?

22 A. Essentially.

23 Q. And isn't it true that the market power

24 will be -- that market power will be reflected in

25 your Shapley value analysis?

1 A. Which market power? Are you talking
2 about that of the -- of the downstream or --

3 Q. Of the single upstream firm.

4 A. Okay. So as I think I went through that
5 a little bit in the slides and in the earlier
6 discussion, that, yes, any market power, that one in
7 concrete that you are referring to, should be and
8 will be reflected through the Shapley calculation.

9 However, I also mentioned that when
10 they're joined together as a single monopolist
11 instead of two monopolists selling two essential
12 inputs, then it will only have the effect, joining
13 them would only have the effect of reducing their
14 Shapley values. That's how it would be reflected,
15 the joining together of them will actually give you
16 a more conservative figure for that side of the
17 market.

18 Q. And that's what Dr. Marks did in her
19 baseline model, correct?

20 A. That's correct, yeah.

21 Q. But in her alternative model, she modeled
22 two upstream suppliers, correct?

23 A. Yes, yes, that's correct.

24 Q. And that would have been -- provided a
25 more -- a more conservative estimate in your words

1 of the royalty rates, correct?

2 A. Less conservative. It would have
3 increased the royalty rates by separating them out.

4 Q. Yes. And so in the way you constructed
5 your model with one upstream monopolist and three
6 competitive downstream firms, you did not use the
7 Shapley value methodology to remove that monopoly
8 power, correct?

9 A. The Shapley value doesn't remove the
10 monopoly power, so I didn't do it.

11 Q. So if you could turn back to
12 Exhibit 1713, and I wanted to reread the sentence we
13 read before. You say --

14 A. Wait. I think we established that there
15 is a poorly worded sentence in there, but I am happy
16 to go back to it.

17 Q. So you disavow the sentence in your
18 published book?

19 JUDGE STRICKLER: Point to the sentence.
20 I don't think you have done it just yet.

21 THE WITNESS: I think it was poorly
22 worded. What my contention is and what my opinion
23 is, my expert opinion is that the Shapley value will
24 eliminate abuse of monopoly power. Maybe that
25 hasn't come through in the sentence you are

1 concentrating so much upon.

2 BY MR. ASSMUS:

3 Q. You draw a distinction between the
4 existence of monopoly power and the abuse of it?

5 A. I do.

6 JUDGE STRICKLER: And how do you
7 distinguish those?

8 THE WITNESS: So existence of monopoly
9 power basically is telling us that a player is very
10 needed and very necessary in a productive process;
11 holds an essential input or something of the sort.

12 Abuse of that power would be a strategic
13 usage of that -- of that situation in order to
14 further increase the payoffs under a holdup scenario
15 or under strategic collaboration with certain of the
16 other inputs, certain of the output suppliers or
17 whatever we may imagine, but existence of it doesn't
18 apply abuse of it necessarily.

19 And what the Shapley model will eliminate
20 is the possibility to abuse it. And the Shapley
21 model will value the fact that it is there, that
22 there is a necessity for some inputs and that that
23 should imply that they should be more generously
24 compensated.

25 JUDGE STRICKLER: Thank you.

1 BY MR. ASSMUS:

2 Q. So your model of one upstream player and
3 three downstream services modeled the upstream
4 player as essential but those downstream players as
5 not essential, correct?

6 A. That's correct.

7 Q. And based on the models that you have
8 constructed, you derive a musical works royalty
9 rate, correct?

10 A. I did.

11 Q. That's the 29.1 percent we discussed
12 previously?

13 A. Indeed.

14 MR. ASSMUS: I need to go into restricted
15 session for just a brief period, Your Honor.

16 JUDGE BARNETT: And you will have more
17 questions after?

18 MR. ASSMUS: I will. It is sort of
19 finishing up the Shapley value section, so I would
20 rather do it now, if that's okay with you.

21 JUDGE BARNETT: Okay. If there is anyone
22 in the hearing room who does not have permission to
23 hear restricted or confidential information, please
24 wait outside.

25 (Whereupon, the trial proceeded in

1 confidential session.)
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1 O P E N S E S S I O N

2 JUDGE BARNETT: While we're doing that,
3 is this deposition transcript the exhibit that was
4 marked 6002 earlier today?

5 MR. ASSMUS: Your Honor, I was using this
6 just for impeachment. I don't believe it has been
7 assigned a number unless I am wrong.

8 THE CLERK: I did assign it a number.

9 MR. ASSMUS: You did? Thank you.

10 JUDGE BARNETT: Are we in agreement it is
11 6002 and it is, which is for impeachment purposes?

12 MR. ASSMUS: Yes, for impeachment.

13 MR. SEMEL: Was that an attempt to offer
14 it into evidence?

15 JUDGE BARNETT: No, it was just an
16 attempt to identify it on the record.

17 MR. SEMEL: Thank you, Your Honor.

18 (Spotify Exhibit 6002 was marked for
19 identification.)

20 MR. ASSMUS: I can offer it if you would
21 like?

22 MR. SEMEL: No, no.

23 BY MR. ASSMUS:

24 Q. So I would like to turn past the Shapley
25 value now. The second part of your report was on

1 economic efficiency.

2 A. True.

3 Q. And you critiqued Dr. Marx's analysis of
4 the rate structure?

5 A. True.

6 Q. You critique, in particular, her support
7 for a revenue, percentage-of-revenue structure,
8 correct?

9 A. Yes.

10 Q. And in your view a per-play and per-user
11 provides certainty?

12 A. Yes.

13 Q. Isn't it true that a Service doesn't know
14 in advance how many streams a user will play?

15 A. Well, that's true. Maybe we should say
16 it provides more certainty. Would that be fair?

17 Q. You acknowledge that the fact that a
18 Service doesn't know how many streams a user will
19 play introduces a level of uncertainty that doesn't
20 exist under a percentage-of-revenue model, correct?

21 A. I would have to think harder about that,
22 where those uncertainties lie and what effects they
23 would have. So I hesitate to answer yes or no to
24 that.

25 Q. You haven't considered that as part of

1 your --

2 A. No.

3 Q. -- report?

4 A. No.

5 Q. And are you aware sitting here today
6 about what the Copyright Owners' proposal is for how
7 to define a stream?

8 A. No, I'm not.

9 Q. Are you aware sitting here today about
10 what the copyright -- how the Copyright Owners
11 propose to define a user?

12 A. No.

13 Q. And prior to forming your opinion, did
14 you review those definitions?

15 A. No, I didn't.

16 Q. We talked about this earlier or you
17 talked about this earlier with your counsel in the
18 courtroom. You are familiar with the term "marginal
19 cost," correct?

20 A. Of course, yes.

21 Q. It is the cost of producing one
22 additional unit of a product or service, correct?

23 A. That's true.

24 Q. And you are also familiar with the
25 economic term "dead weight loss"?

1 A. Yes, I am.

2 Q. And I believe you testified previously
3 that in your view the marginal cost to Spotify to
4 produce an additional stream is effectively zero?

5 A. Well, I have put it, I have forwarded
6 that idea in the -- in the report that I have got,
7 but I haven't been able to actually measure that.

8 Q. For purposes of your analysis you assumed
9 it was effectively zero?

10 A. I didn't need that in my analysis, so I
11 haven't made any assumption on it.

12 Q. Do you have a view sitting here today
13 about what the marginal cost of an additional stream
14 is?

15 A. No, the same. I believe it is very
16 small.

17 Q. And not just for Spotify but for any of
18 the Services represented here, correct?

19 A. I think if anything, I have taken -- you
20 said off a stream, right?

21 Q. Of a stream, correct.

22 A. I think it was in the original Marx
23 report itself that suggested that that's zero.

24 Q. And if a Service was to charge its
25 subscribers on a per-stream basis, that would

1 potentially create an economic inefficiency,
2 correct?

3 A. I don't know if that's true because I've
4 placed in the report an appendix which shows that I
5 can always create an example where that doesn't
6 happen.

7 And I think I discussed that as well
8 earlier today that if the per-unit rate isn't a
9 substitution of the second cost, which was the
10 revenue sharing, then there is movements in both
11 directions. So I honestly can't say or I don't
12 think anyone can say which, which would -- where the
13 welfare would increase or decrease.

14 Q. Could you take a look at your deposition,
15 now page 197. In particular, line 11. I asked you:

16 "Question: So if Spotify were to charge
17 its subscribers on a per-stream basis, using your
18 assumption about the marginal cost of an additional
19 stream, that would involve an economic inefficiency,
20 correct?

21 "Answer: So you -- it would involve --
22 if that were the only -- you're saying that's the
23 only basis of charge?

24 "Answer: Yes.

25 "Answer: Yes. Well, it would involve an

1 inefficiency."

2 "Question: And that would, in fact, be a
3 dead weight loss?"

4 A. It would.

5 Q. You recall that testimony?

6 A. I don't recall it, but I see it here.

7 Q. Now, I understand your view is that just
8 because a Service faced a positive price for a
9 marginal stream, positive input price, in your view
10 would not necessarily mean that they would charge a
11 positive price to the user, correct?

12 A. Correct.

13 Q. However, in your report you note that
14 Services could take per-play and per-user royalty
15 costs, mark them up by a percentage, and pass them
16 on to users in variations on their existing pricing
17 promos, correct?

18 A. That's correct. And I think the
19 important word there is "could."

20 Q. And --

21 JUDGE STRICKLER: Why is "could"
22 important?

23 THE WITNESS: Because -- because I don't
24 think -- and my testimony earlier is that it is a
25 possibility that is something they might want to do,

1 but it is also something they might not want to do.
2 And as we see in the current market and as there are
3 other examples in the economics that show us.

4 JUDGE STRICKLER: Should we take as a
5 revealed preference in the marketplace the fact that
6 the Services use these revenue sharing -- these
7 subscription approaches that they do have that as
8 the de facto default efficient way of pricing?
9 Because that's what the way they voluntarily do it?

10 THE WITNESS: Yeah, I think there is
11 strong evidence. It is information that informs us
12 very clearly.

13 JUDGE STRICKLER: Thank you.

14 BY MR. ASSMUS:

15 Q. Isn't it true that the level and form of
16 the royalties set here will affect the optimal
17 pricing strategies of the Services?

18 A. Well, again, I am not sure. So the
19 question is how -- how do they -- what is the
20 optimum strategy of Services to set prices? And
21 that, I don't know. I don't know how they establish
22 their prices.

23 So to the extent then that this will have
24 an effect, the rate structure, I think is what you
25 asked, will have an effect, I don't know, because I

1 don't know in the real world how that happens.

2 Q. Is it your testimony that a per-stream
3 rate would have no impact on the incentives of the
4 Services in pricing marginal streams?

5 A. Again, I think I don't know the answer to
6 that because I don't know how they work out -- how
7 they price to the consumer.

8 Q. So you haven't inquired of the Services
9 about how they do price their outputs?

10 A. I haven't, no.

11 Q. And you haven't credited the statements
12 in the record from the Services on their pricing
13 decisions?

14 A. So I haven't what?

15 Q. You haven't credited the statements from
16 the Services on their pricing decisions if they
17 faced a --

18 A. I don't know what statements you are
19 referring to, so I haven't mentioned them. Is that
20 what you mean?

21 Q. One of the statements you reviewed is the
22 written statement of Barry McCarthy, Spotify's CFO,
23 correct?

24 A. I reviewed a part of it, yeah.

25 Q. And you in connection with your report

1 credited one of the things he said, correct?

2 A. Yeah.

3 Q. But you haven't credited anything Mr.
4 McCarthy said about Spotify's pricing strategies?

5 A. No, no, I haven't used that.

6 Q. And you haven't reviewed any documents
7 regarding the Services' pricing strategies?

8 A. I haven't.

9 Q. Have you asked for any of those
10 documents?

11 A. No.

12 Q. And if I understand your report
13 correctly, the basis for your view that Services
14 would not price on a per-stream basis in face of a
15 per-stream royalty cost is in part an analogy to a
16 buffet restaurant, correct?

17 A. In part, yeah.

18 Q. And like an interactive service, a buffet
19 restaurant charges an access price but then
20 literally an all-you-can-eat marginal price?

21 A. That's true.

22 Q. In paragraph 17 of your report you say
23 "buffets face positive marginal costs but certainly
24 those restaurants make no effort to discourage
25 patrons from attending the efforts or discourage

1 diners in the restaurant from eating." Does that
2 sound right?

3 A. That sounds right.

4 Q. Your basis for opining on the business
5 practices of buffet restaurants is your own dining
6 experiences, correct?

7 A. Pure observation.

8 Q. You have never consulted for a buffet
9 restaurant business?

10 A. No. I think we established that in
11 deposition.

12 Q. We did, indeed. And you have never
13 analyzed as an economic matter the business
14 strategies of buffet restaurants?

15 A. No, I haven't.

16 Q. You go on to say in paragraph 17, "if
17 buffet restaurants were to somehow be seen to
18 discourage dining at the margin, surely they would
19 simply lose customers to rival businesses."

20 A. I think that's true.

21 Q. That is also based on your personal
22 observations?

23 A. Yeah.

24 Q. You go on to say in your report, "The
25 same would be expected to occur in the interactive

1 streaming business."

2 A. That's so.

3 Q. Likewise, based on your personal
4 observations?

5 A. Likewise.

6 Q. You haven't studied the user behavior of
7 streaming users?

8 A. No, I am making an analogy and using my
9 logic. That's all.

10 Q. You haven't reviewed any documents
11 produced by the Services in this case about the
12 behavior of their users?

13 A. No.

14 Q. You haven't asked for any?

15 A. Well, there is, on that point, I suppose,
16 there is some -- I don't recall which of the
17 documents, it is probably in a footnote in the
18 report that pricing changes at least would -- is it
19 Mr. McCarthy's report that pricing changes would
20 essentially drive consumers to competing service.

21 So I suppose if that's what you are
22 referring to, something like that, I have seen that.
23 And I think there is a footnote around that in the
24 report somewhere. I don't recall what it might be.

25 Q. But nothing else you can remember?

1 A. No, nothing else I can recall.

2 Q. One aspect of your report is that you
3 believe maybe there are measurement problems with
4 respect to a percentage-of-revenue model, correct?

5 A. Indeed, indeed.

6 Q. And, in fact, with respect to your
7 Shapley value analysis, you have made in your report
8 and here today the point that to return reliable
9 results, the Shapley value needs reliable revenue
10 inputs, correct?

11 A. That's true.

12 Q. And you give in your report bundling as
13 an example of a potential revenue issue?

14 A. I do.

15 Q. You use Amazon as an example?

16 A. Yeah.

17 Q. And Amazon in the instances you cite is
18 bundling music services with other services it
19 provides itself, correct?

20 A. Yes, that's correct.

21 Q. And if I could direct your attention to
22 paragraph 55 of your report.

23 A. Can you tell me where it is?

24 Q. Yes, I can. It is Exhibit 3034,
25 previously admitted.

1 A. It is here someplace?

2 MR. SEMEL: It is in the binder we have
3 this morning.

4 BY MR. ASSMUS:

5 Q. You can use your binder if you would
6 like, if it is easier to find.

7 MR. SEMEL: It is in both.

8 JUDGE FEDER: Second volume of the cross
9 binder.

10 THE WITNESS: I think it is here, right.
11 This is the first one.

12 BY MR. ASSMUS:

13 Q. Whichever copy of Exhibit 3034 you can
14 find.

15 A. Here is one here. Okie-dokie. What --

16 Q. In the last sentence of page or paragraph
17 55 you say, "Moreover, this type of bundling appears
18 to be a business model that Spotify itself is now
19 seeking to emulate."

20 A. Okay. I have got it.

21 Q. Are you aware of any of the bundles that
22 Spotify currently offers in the U.S. market?

23 A. Yes, I'm aware of one which is a bundle
24 with a newspaper. Is that -- is that correct?

25 Q. Is that newspaper The New York Times?

1 A. Yeah, I think.

2 Q. Are you aware of any other bundles
3 Spotify offers --

4 A. No, I am not aware of any others.

5 Q. And that is a third part in the bundle,
6 correct?

7 A. I assume -- I don't know. I don't know
8 what the ownership of those businesses look like,
9 but one would have to assume that Spotify doesn't
10 own The New York Times. Is that what you are asking
11 me?

12 Q. I am. The New York Times is a
13 third-party to Spotify, correct?

14 A. Correct, I believe you.

15 Q. This is a bundle of two different
16 companies' products, correct?

17 A. I believe you.

18 Q. And therefore the revenue from that
19 bundle would need to be split between the parties to
20 that bundle, correct?

21 A. I have no information on how they are, at
22 all.

23 Q. You are not aware of the economic terms
24 of their bundle?

25 A. Not at all.

1 Q. You suggest in paragraph 4 of your report
2 that in order to implement a revenue sharing
3 arrangement in a fair and correct manner, it would
4 require more information that would be costly to
5 gather, correct?

6 A. Correct.

7 Q. And without going into the details, you
8 understand that percentage-of-revenue royalties do
9 exist in the music industry, correct?

10 A. Yes, of course.

11 Q. Including in voluntary agreements between
12 labels, publishers, and services, correct?

13 A. Well, I am not aware of those ones, but
14 I'm aware that there are.

15 JUDGE STRICKLER: So the record is clear
16 you say in -- new word -- voluntary agreements,
17 right?

18 MR. ASSMUS: Thank you, Your Honor.

19 BY MR. ASSMUS:

20 Q. I mean with respect to voluntary
21 agreements.

22 JUDGE STRICKLER: Thank you. I want the
23 record to be clear.

24 BY MR. ASSMUS:

25 Q. You didn't, in connection with your

1 testimony, review marketplace agreements, voluntary
2 marketplace agreements between labels, publishers,
3 and Services?

4 A. No, not particularly, no. I was made
5 aware of some, but I haven't used it or -- no, it
6 hasn't been a factor in what I did.

7 Q. But you are aware at least some of those
8 are based on a percentage-of-revenue royalty,
9 correct?

10 A. I wasn't aware of it necessarily, but I
11 believe you.

12 JUDGE STRICKLER: In preparing your
13 report, did you ask for that information, as to
14 whether percentage-of-revenue pricing was utilizing
15 the upstream market?

16 THE WITNESS: No I don't believe I asked
17 for it specifically, no.

18 BY MR. ASSMUS:

19 Q. Okay. I would like to finish up,
20 Dr. Watt, with -- making sure I understand what you
21 did and didn't do in your report.

22 You have not considered the impact of the
23 Copyright Owners' rate proposal on any of the
24 Services, correct?

25 A. So I haven't analyzed the copyright

1 holders rate proposal. I was asked to analyze
2 the -- Dr. Marx's report, and that's what I did.

3 Q. So I take it you have not analyzed?

4 A. I have not, no.

5 Q. And did you -- and you didn't -- you
6 didn't consider the fourth 801(b) factor,
7 disruption, did you?

8 A. No. I considered what was in Dr. Marx's
9 report and there was no -- no talk of that.

10 Q. So just to be clear, you have not
11 considered in connection with your analysis the
12 fourth 801(b) factor, the disruption factor?

13 A. I haven't necessarily done that. We
14 talked about it earlier today, how it can be
15 inferred from the modeling that I did in the sense
16 that if non-disruptiveness is that the total royalty
17 pool wouldn't change much, then it is considered,
18 but I didn't set out with that in mind.

19 MR. ASSMUS: I have nothing further on
20 cross. Thank you.

21 JUDGE BARNETT: Thank you.

22 JUDGE STRICKLER: I have a question
23 before we get to redirect. I am taking you back to
24 that unfortunate tortured sentence from your
25 chapter, which is Exhibit 1713.

1 THE WITNESS: Yes.

2 JUDGE STRICKLER: And I am going to read
3 it the way you wanted it corrected and you tell me
4 if I corrected it properly. It should have said:
5 "The use of the Shapley methodology allows us to
6 remove any abuse of monopoly power the copyright
7 holders may otherwise hold when they combine as a
8 single bargaining unit under a copyright
9 collective."

10 THE WITNESS: Yes. That's how I would
11 have -- that's how I should have said it, yeah.

12 JUDGE STRICKLER: Then let me ask you
13 this. Are you saying -- do you have it in front of
14 you? I want to make sure you have the language.

15 THE WITNESS: It is somewhere here, but I
16 have so many things in front of me I don't know
17 where that is any more.

18 JUDGE STRICKLER: Exhibit 1713. It does
19 get busy up there.

20 THE WITNESS: Hang on. It is in one of
21 these exhibits. I think it is here. I can see it
22 here, that's easier.

23 JUDGE STRICKLER: Help you out, okay. So
24 with the words to remove "any monopoly power"
25 changed to be, as you would prefer it to be to

1 remove any abuse of monopoly power?

2 THE WITNESS: Yes.

3 JUDGE STRICKLER: Are you saying in that
4 sentence that you understand that copyright holders
5 as individuals, as holders of individual copyrights
6 don't have market power, but when they combine as a
7 single bargaining unit under a copyright collective,
8 that that gives them the ability to abuse monopoly
9 power?

10 THE WITNESS: It gives them the
11 potential, right? So I think that that's a -- what
12 you are talking around is a standard income, you
13 know, input assumption into almost all the these and
14 also copyright collective societies, that there are
15 good efficiency reasons why they should be, you
16 know, organized and negotiated and, you know, work
17 together as a single unit, why is there a blanket
18 license rather than individual licenses for
19 individual songs.

20 JUDGE STRICKLER: From transaction.

21 THE WITNESS: The transactions cost
22 motive and there is others. And I have a paper
23 where bundling and risk sharing and these sorts of
24 things also point in the direction of that being
25 efficient.

1 So it is standardly assumed that that
2 comes at a cost, that there is now a single seller
3 of that big bundle input, which is a repertoire,
4 which confers greater monopoly power on that side of
5 the market than if they were separated.

6 JUDGE STRICKLER: And can you use the
7 Shapley methodology to sort of throw out the bath
8 water and keep the baby, I might say, so that you
9 can keep the efficiencies of the monopoly of the
10 collective while eliminating the bath water of the
11 monopoly pricing?

12 THE WITNESS: Yeah, so I am not sure --
13 what the Shapley model will do is to value that
14 repertoire as a single input now and value how
15 important it is as an input into whatever usages are
16 made of it.

17 But what it will eliminate is the
18 possibility that it would be used inappropriately,
19 that that club will be used inappropriately against
20 the users in a way to extract monopoly rents over
21 and above a reasonable value of their -- of the
22 contribution of that input.

23 JUDGE STRICKLER: How does the Shapley
24 methodology accommodate that?

25 THE WITNESS: So what the Shapley

1 methodology will do for us is to eliminate the --
2 that possible abuse, if there were any. And so it
3 does that by simply valuing what is the, you know,
4 what is the contribution of that input over every
5 possible ordering between the players in the model.

6 So it avoids the problem that that player
7 always turns up last or that that player decides
8 only to license to one or two output suppliers and
9 not all, that sort of thing.

10 JUDGE STRICKLER: You wouldn't need to
11 disaggregate the collective in terms of, in other
12 words, do a Shapley analysis to figure out the
13 value?

14 THE WITNESS: To individual copyright
15 holders?

16 JUDGE STRICKLER: Yes.

17 THE WITNESS: I mean, that is an
18 impossibility because there is so many millions of
19 them that it is just not possible. It is even not
20 clear to me, I can't imagine how anyone could even
21 approach that problem, but it is not clear to me
22 even what that would do to the power on that side of
23 the market, in a scenario in which it is envisaged
24 that all of the music is necessary.

25 Now if you disaggregate down to

1 individual songs, I'm sure not every single one of
2 the billions of songs is going to be classified as
3 being an essential input.

4 I recall -- you know, it goes back, I
5 think as well to something that Mr. Assmus has shown
6 us today, the case in New Zealand, where there were
7 five labels that were represented by a single
8 collective.

9 When the -- so when it was argued the
10 same point, should we run the Shapley with these
11 labels disaggregated, they were all seen as being
12 essential inputs. So having them aggregated
13 together, you know, it helps to simplify the model a
14 lot, but it also gives you a single Shapley payoff
15 to those five, rather than working out each five and
16 having five essential inputs instead of one.

17 JUDGE STRICKLER: Thank you.

18 MR. ASSMUS: Maybe the panel would
19 consider whether you would like Exhibit 1713 in
20 evidence, given the extensive discussion of it.
21 That's the Shapley value chapter we have been
22 discussing.

23 MR. SEMEL: I, if the panel would like
24 that into evidence, he seems to be offering it if
25 you want it, so if you want it --

1 JUDGE BARNETT: Sure. 1713 is admitted.
2 (Spotify Exhibit Number 1713 was marked
3 and received into evidence.)

4 MR. SEMEL: And I have no additional
5 questions for the witness.

6 JUDGE BARNETT: Okay. Anything further
7 from the panel? Thank you, Dr. Watt. You may be
8 excused.

9 THE WITNESS: Thank you very much.

10 JUDGE FEDER: Safe travels.

11 THE WITNESS: Thank you.

12 JUDGE BARNETT: Given that we're between
13 witnesses, it is a little early, but maybe we should
14 go ahead and take our afternoon recess at this
15 point. We'll do that.

16 (A recess was taken at 2:39 p.m., after
17 which the hearing resumed at 2:59 p.m.)

18 JUDGE BARNETT: Please be seated. For
19 those news watchers in the room, we received notice
20 from the Federal Register that the Subpart A regs
21 will be published tomorrow.

22 You are waiting for me, Mr. Scibilia?

23 MR. SCIBILIA: Sure are.

24 JUDGE BARNETT: Let's proceed.

25 MR. SCIBILIA: Copyright Owners would

1 like to call David Kokakis to the stand.

2 JUDGE BARNETT: Thank you. Mr. Kokakis,
3 could you please stand up and raise your right hand.

4 THE WITNESS: Yes.

5 Whereupon--

6 DAVID KOKAKIS,
7 having been first duly sworn, was examined and
8 testified as follows:

9 MR. ELKIN: Your Honor, may I briefly
10 address one issue? Mr. Mancini of Spotify is going
11 to be handling the cross today, but there are a
12 couple of documents, exhibits that we move, and I
13 understand the panel's position with regard to
14 adjudicating that motion, you know, at some point in
15 the future, but I would like to be heard, if and
16 when the exhibits are introduced into evidence with
17 regard to issues that we have raised because it has
18 a bearing on the introduction of them.

19 JUDGE BARNETT: Okay. Thank you, Mr.
20 Elkin.

21 MR. ELKIN: Thank you. Is Mr. Mancini
22 aware of when to queue you or you will just be
23 listening?

24 MR. MANCINI: I think we will be. There
25 also may be some portions of Mr. Kokakis's testimony

1 that go to the motion in limine that we filed. If
2 he seeks to speak to them verbally, we may be
3 objecting to portions.

4 JUDGE BARNETT: You certainly may make
5 sure that that objection is on the record, but it is
6 pending anyway, so even if it isn't on the record, I
7 think it is in the record.

8 MR. MANCINI: Fine. Thank you, Your
9 Honor.

10 JUDGE BARNETT: Thank you.

11 DIRECT EXAMINATION

12 BY MR. SCIBILIA:

13 Q. Thank you, Your Honors. Good afternoon,
14 Mr. Kokakis.

15 A. Good afternoon.

16 Q. Have you directed the preparation of some
17 demonstrative slides to accompany your testimony
18 today?

19 A. I did. They essentially track my prior
20 testimony.

21 JUDGE BARNETT: Can we back up and get
22 Mr. Kokakis to put his name on the record and spell
23 your last name, please?

24 THE WITNESS: Certainly. My name is
25 David Kokakis, last name spelled K-o-k-a-k-i-s.

1 JUDGE BARNETT: Thank you.

2 MR. SCIBILIA: With Your Honor's
3 permission, I would like to display those
4 demonstrative slides.

5 JUDGE BARNETT: Sure.

6 BY MR. SCIBILIA:

7 Q. Where are you employed?

8 A. Universal Music Publishing Group.

9 Q. And what is your title?

10 A. Executive vice president and head of
11 business and legal affairs, business development,
12 and digital.

13 Q. And what are your responsibilities in
14 that position?

15 A. I oversee contract negotiations for the
16 company and all legal matters, litigation matters.
17 Particularly relevant to these proceedings, I
18 oversee the licensing of digital services that fall
19 within Section 115 of the Copyright Act.

20 JUDGE STRICKLER: Is there a parent
21 company to your employer?

22 THE WITNESS: There is, Universal Music
23 Group, which has various holdings, including a group
24 of recording music companies, record labels,
25 merchandising companies and some other properties.

1 JUDGE STRICKLER: Thank you.

2 BY MR. SCIBILIA:

3 Q. When did you join Universal Music
4 Publishing Group?

5 A. In 2009.

6 Q. And were you a songwriter or an artist in
7 a prior life?

8 A. In this life, but when I was much
9 younger, yes, songwriter, an artist, I was signed to
10 a record deal in my teens, I toured extensively as a
11 producer, and then an artist advocate for many years
12 in private practice before joining Universal.

13 Q. And did you submit written direct
14 testimony in this proceeding?

15 A. I did, yes.

16 Q. I would like you to look at Exhibit 3018,
17 which is in your binder.

18 JUDGE BARNETT: I'm sorry, Mr. Scibilia.
19 Could you repeat the exhibit number?

20 MR. SCIBILIA: Sure, it is 3018.

21 JUDGE BARNETT: I thought I heard you.
22 Thank you.

23 BY MR. SCIBILIA:

24 Q. Is that your signature on the last page?

25 A. Yes, it is.

1 Q. And did you submit rebuttal testimony in
2 this proceeding?

3 A. Yes, I did.

4 Q. I would like you to look at Exhibit 3031.
5 Is that your written rebuttal testimony in this
6 proceeding?

7 A. Yes, it is.

8 Q. And is that your signature on page 8?

9 A. Yes, it is.

10 MR. SCIBILIA: I would like to offer
11 Exhibits 3018 and 3031 into evidence at this time.

12 MR. ELKIN: Objection, Your Honor. We
13 have a motion in limine pending. We understand the
14 panel's preference to hear that post the hearing,
15 preserve our -- an opportunity to specifically
16 object to testimony as it relates to exhibits when
17 they are introduced.

18 JUDGE BARNETT: Okay, thank you. Mr.
19 Marks?

20 MR. MARKS: The same objection.

21 JUDGE BARNETT: Mr. Mancini?

22 MR. MANCINI: Same objection, just a
23 further clarification, and to certain portions of
24 the testimony that per our motion in limine we
25 sought to strike.

1 JUDGE BARNETT: Understood. And we, when
2 we rule on the motion, we will let you know which
3 portions if any of the testimony that we are going
4 to disregard in our decisionmaking.

5 MR. MANCINI: Thank you, Your Honor.

6 JUDGE BARNETT: Thank you.

7 BY MR. SCIBILIA:

8 Q. How many musical works does --

9 THE REPORTER: I'm sorry, Your Honor, are
10 the exhibits admitted?

11 JUDGE BARNETT: Yes, they are admitted.

12 (Copyright Owners Exhibit Numbers 3018
13 and 3031 were marked and received into evidence.)

14 BY MR. SCIBILIA:

15 Q. How many musical works does Universal
16 Music Publishing Group own or administer?

17 A. Well over 3 million, approaching 4
18 million.

19 Q. And who are some of the songwriters
20 currently signed to Universal Music Publishing?

21 A. Some of the artists listed here, Adele,
22 Coldplay, YouTube, Justin Timberlake, Justin Bieber,
23 Ariana Grande, Selena Gomez, and many others.

24 Q. And in addition to current writers, does
25 Universal Music Publishing also own or administer

1 copyrights in existing musical works?

2 A. Existing musical works meaning catalogue?

3 Q. Yes.

4 A. Sure. We represent catalogues of Neil
5 Diamond, Billy Joel, Paul Simon, many jazz
6 standards, classical music catalogues, R&B
7 catalogues, such as Def Jam Music and Sugar Hill.

8 Q. In your written direct testimony, you
9 discuss some of the roles that music publishers such
10 as Universal Music Publishing play in the music
11 industry. Can you walk us through some of the
12 things that music publishers do?

13 A. Certainly. We are primarily charged with
14 the responsibility of finding new talent. And then,
15 of course, developing that talent and investing in
16 the talent, finding opportunities for the talent to
17 expose music and exploit music throughout the world.

18 Q. How do music publishers discover new
19 talent?

20 A. There are a variety of ways. We have a
21 global A&R staff, which stands for artist and
22 repertoire, the creative team. We operate in 57
23 countries -- excuse me, 57 offices across 47
24 countries is the last statistic I believe is
25 accurate.

1 And we have dedicated creative staff in
2 all of those offices that goes to live shows, goes
3 on-line to read entertainment blogs. We have a
4 massive network of managers and talent finders and
5 music supervisors, relationships throughout the
6 industry. And much of the talent-finding process is
7 referral-based.

8 And we receive demonstration recordings,
9 no longer on cassette tape or on disk but rather MP3
10 files or MP4 files forwarded to us and our creative
11 staff evaluates those.

12 Q. Are the creative staff trained in any
13 way?

14 A. Some are former musicians. Some are
15 former songwriters. But for the most part they use
16 what I would call magic, in my prior testimony
17 during my deposition. They have what is known as an
18 ear for hearing a hit song. And that's typically
19 what drives the evaluation process.

20 Q. Does Universal Music Publishing do
21 anything to nurture songwriters once they are signed
22 to Universal?

23 A. Certainly. There are lots of things we
24 do. We, of course, invest in the talent, give large
25 advances sometimes to artists to help them quit

1 their day job so they can focus exclusively on
2 songwriting.

3 We have a large staff of creative
4 personnel, as I mentioned, that sets up co-writing
5 opportunities for the writers by introducing them to
6 other writers who they can collaborate with. They
7 introduce them to artists who are looking for songs.

8 And we have a massive network of film and
9 TV executives throughout the world that pitch
10 actively to film companies, TV studios, commercial
11 ad agencies. And we have a network of labels that
12 we do business with, and we often pitch songs to
13 those labels when they are looking for songs for
14 particular artist projects.

15 Q. Does Universal Music Publishing perform
16 any tasks with respect to the musical works once
17 they have been written?

18 A. Certainly. We plug a composition into
19 our network, as I described both creative and film
20 and TV, and we actively pitch songs. We look for
21 opportunities in film and TV projects, advertising
22 projects, on albums that are being created by
23 well-known recording artists who are looking for
24 third-party songs, so they can record and perform
25 them.

1 Q. Okay. And those would be licenses that
2 you would enter into?

3 A. Certainly. We would license the song for
4 these various types of uses whether for film and TV,
5 whether to a record label for exploitation on an
6 artist's record. And of course we license to the
7 types of digital companies that are part of this
8 proceeding.

9 Q. Okay. Does Universal Music Publishing
10 Group perform any services regarding or with respect
11 to royalty collection and tracking?

12 A. We do.

13 Q. What are those services?

14 A. Sure. We have a global network of admin
15 staff and accountants that are charged with the
16 responsibility of collecting royalties from
17 societies, from record labels, from other parties
18 that utilize our music and process those royalties
19 and regular accountings and payments to the
20 songwriters.

21 And we register copyrights globally at
22 the society level for the various performance rights
23 organizations throughout the world. And in the
24 U.S., for instance, we register with the U.S.
25 Copyright Office to make sure that our songs qualify

1 for federal copyright protection.

2 Q. Does Universal Music Publishing take any
3 efforts to protect songwriters' legal rights?

4 A. Yes. We have a robust antipiracy
5 program. And we engage in takedowns of our content
6 on-line. Quite often we send DMCA takedown notices
7 for that purpose. We issue cease and desist letters
8 to infringing parties. We will initiate litigation
9 against parties when necessary.

10 Just to give a sense of the scale, we are
11 now issuing upward of 2,000 DMCA takedown notices a
12 day in the U.S. and have built out an infrastructure
13 to deal with that sort of volume.

14 Q. Do you believe the mechanical-only minima
15 serves an important purpose in the current statute?

16 A. Absolutely, yes, it does.

17 Q. And what is your belief about that?

18 A. Well, the mechanical royalty is quite an
19 important income stream for us. The mechanical
20 right is separately delineated in the Copyright Act,
21 of course, so we treat it as a separate right apart
22 from performance and other rights that are specified
23 in the Copyright Act.

24 So we believe it is important to preserve
25 the sanctity of the mechanical right in the

1 mechanical royalty pool.

2 And our writers are paid the bulk of that
3 revenue of all income types, it is the income type
4 that the songwriter shares in, to the greatest
5 extent more so than other income streams.

6 And as opposed to performance, for
7 instance, where the songwriter will typically get
8 half of the income stream; on the mechanical side,
9 songwriters get 75 percent, upwards of 95 percent of
10 that pool. So it is particularly important when
11 looking at recouping artist advances.

12 It enables the artist to recoup faster,
13 which keeps the payments flowing to them. There are
14 often contractual obligations we have to trigger
15 additional advances to the writers that are linked
16 to recoupment, so the mechanical royalty pool is
17 arguably the most important pool in that recoupment
18 process.

19 JUDGE FEDER: Excuse me, Mr. Kokakis.

20 THE WITNESS: Yes.

21 JUDGE FEDER: You said that I believe
22 performance royalty, the songwriter gets about
23 50 percent; is that correct?

24 THE WITNESS: Yes, for the income that we
25 collect, the songwriter gets 50 percent.

1 JUDGE FEDER: And who gets the other
2 50 percent?

3 THE WITNESS: The other 50 percent is
4 passed through to the songwriter directly,
5 represents the songwriter's share of performance
6 revenue. And that income is passed through without
7 regard to recoupment.

8 So even in instances of direct licensing
9 with performance rights, which we do quite often
10 these days, we pass through that royalty pool
11 directly to the songwriters.

12 JUDGE FEDER: Thank you.

13 BY MR. SCIBILIA:

14 Q. Does the mechanical-only floor also
15 provide protection that does not exist in the other
16 two prongs of the current statute; that is, the
17 percentage-of-revenue prong and the total content
18 cost prong?

19 A. It establishes a minimum value for the
20 mechanical right. And we encounter problems with
21 the other tiers, the percentage-of-revenue tier and
22 the TCC prong that we don't have with the mechanical
23 royalty floor because the floor can't be diluted.

24 Q. What are the problems you have with the
25 percentage-of-revenue prong and the total content

1 cost prong?

2 A. With the percentage-of-revenue prong we
3 have what we sometimes refer to as royalty
4 displacement and royalty deferral or deferment. And
5 I will explain what those are.

6 Royalty deferment will refer to a service
7 trading a value of music and trading revenue for an
8 increased user base. And the Services' objective is
9 to attract new users to scale the subscriber base,
10 for instance. And often that is done at the expense
11 of maximized revenue that the Service would
12 otherwise enjoy if it were to focus more on
13 advertising and increasing monetization.

14 And the reason that's detrimental to the
15 songwriter is because the songwriters don't often
16 want to wait for a service to scale to become
17 profitable, to start generating meaningful revenue.
18 So songwriters are experiencing this deferment that
19 sometimes passes them by because usually songwriters
20 experience a moment in time when they are successful
21 and their revenue should flow through today as
22 opposed to waiting several years down the road,
23 five, ten years when perhaps the songwriter isn't as
24 relevant in the market anymore and won't be able to
25 enjoy the upside that songwriter would enjoy today.

1 As far as the displacement issue, we see
2 some services also trade value of music for other
3 things of interest to the Service that doesn't
4 benefit the publishers or the songwriters. By way
5 of example, Amazon Prime has its bundled service
6 where the value attributable to music --

7 Q. Hold on a second. I want to make sure
8 we're not going into restricted here. Without
9 disclosing terms of any of Amazon's deals, can you
10 mention briefly what you believe about the
11 displacement?

12 A. Sure. As it relates to my example with
13 Amazon Prime or just in general?

14 Q. Sure, in general.

15 A. Without discussing terms, Services such
16 as Amazon and many of the others that are part of
17 this proceeding will look for an increased user
18 base, increased stock price, they will sell other
19 items.

20 There is the Google Home device. There
21 is the iPhone. There is the Amazon Echo.

22 And we don't share in the sale of or the
23 proceeds from the sale of any of those devices. But
24 music is a driver for pushing users into these other
25 places that trigger monetization for the Services

1 that aren't shared with the content owners.

2 Q. What about the TCC prong?

3 A. The TCC prong is problematic in part
4 because there is very little transparency to it.
5 And publishers on the whole, Universal included, of
6 course, are skeptical as to whether we're capturing
7 all of the revenue that could otherwise be generated
8 or should be generated under a TCC prong.

9 We don't know if the prong is capturing
10 equity that the labels may hold. We don't know it
11 is capturing the value of marketing activities that
12 the labels receive.

13 The TCC prong also has a ceiling of 80
14 cents generally that we would often bump up against,
15 even if all of these other revenue streams and
16 consideration that the labels receive would be
17 factored into the TCC prong.

18 So we don't believe that it is really
19 working in practice.

20 Q. I believe you testified, let me ask the
21 question, is the writer's share of public
22 performance royalties used to recoup advances paid
23 by Universal Music Publishing Group to the
24 songwriter?

25 A. No. As I just mentioned a moment ago to

1 Judge Feder -- is it Feder?

2 JUDGE FEDER: Yes. Thank you.

3 THE WITNESS: We do not use the writer's
4 share of performance income to recoup advances. We
5 maintain the sanctity of that revenue pool for the
6 writers.

7 BY MR. SCIBILIA:

8 Q. And is that true also in cases where
9 Universal Music Publishing Group licenses
10 performance rights directly as opposed to them being
11 licensed through a PRO?

12 A. Yes. As I believe I also stated to Judge
13 Feder, we do not cross against the writer's share of
14 performance royalties even when we license and
15 collect that revenue stream directly.

16 Q. Now, there has been some mention in this
17 proceeding of partial and full withdrawals by
18 publishers from PROs.

19 Has Universal Music Publishing Group ever
20 partially or fully withdrawn from a PRO?

21 A. Yes. We partially withdrew for a brief
22 time back in 2012 or '13, may have been different
23 years, for ASCAP and BMI. And what we attempted to
24 do was withdraw our media rights or digital rights
25 so we could engage in the direct licensing of those

1 rights without having the societies involved in that
2 process. And that is what ultimately led to the
3 Pandora rate court proceedings with BMI and ASCAP.

4 And the results from those hearings or
5 those proceedings were essentially that we could not
6 partially withdraw our rights from either ASCAP or
7 BMI because it was deemed to be a consent decree
8 violation.

9 And with respect to full withdrawal, in
10 2014, I believe, Universal was fully withdrawn from
11 BMI for a short period of time.

12 Q. What were the circumstances as to why
13 Universal Music Publishing Group was fully withdrawn
14 from BMI?

15 A. Well, we had issued a notice to BMI to
16 withdraw our partial rights for digital, and entered
17 into an agreement with BMI to that effect, but
18 because of Judge Stanton's ruling in the BMI rate
19 court proceeding, he essentially ruled that you are
20 either in or out. And if you allow your notice of
21 withdrawal of digital rights to stand, then the
22 consequence is that you are out fully.

23 And we allowed the notice to stand. And
24 as a consequence we were out. We did so because
25 there were several issues we had to work through

1 with BMI that we had encountered during the process
2 of attempting to withdraw rights partially.

3 And we took it as an opportunity to fix
4 those problems with BMI and enter into a new
5 arrangement with BMI that I think is much more
6 favorable to us than what we had been accustomed to
7 for decades, really.

8 Q. So did you encounter any difficulties
9 while you were briefly out of BMI?

10 A. We did. It was an incredibly stressful
11 time because I think what came to light is that we
12 had underestimated the dedication of resources that
13 it would require us to set aside in order to get
14 coverage for all of the various licensing points
15 that the societies, BMI in particular, was covering
16 for us.

17 There is a great deal of benefit that
18 comes from collective licensing and talking about
19 literally hundreds of thousands of licensing points
20 that we had not become accustomed to dealing with
21 directly for decades, specifically in the general
22 licensing category for performance rights bars,
23 restaurants, dance studios, concert venues,
24 department stores.

25 And, of course, there are other

1 categories that we didn't have an expertise in
2 dealing with, such as licensing to radio, licensing
3 on a blanket basis for performance rights to TV,
4 broadcast TV in particular, to cable.

5 And we realized it would require an
6 investment of likely north of 15 to 20 million
7 dollars to build out the infrastructure necessary to
8 deal with all of this and that we would have to do
9 it essentially overnight.

10 So for all of our good intentions there
11 were unintended consequences that we just didn't
12 anticipate and the process became overwhelming.

13 Q. How long were you out of BMI?

14 A. Approximately a month.

15 Q. Have you ever told any of the
16 representatives of any of the Services in this
17 proceeding that Universal intends to fully withdraw
18 from a PRO?

19 A. That we intend to, no. We had discussed
20 at times possibility of Universal withdrawing
21 because it was a question sometimes asked by the
22 Services and other licensees who wanted to know what
23 to expect from the market.

24 Q. And during what period was that?

25 A. That was in the wake of the BMI and ASCAP

1 rate court proceedings where there was a lot of
2 uncertainty as to whether we would be allowed to
3 withdraw rights partially and what the consequences
4 would be if we attempted to do so. And as we saw
5 with the BMI rate court ruling, we would be out of
6 BMI fully if we allowed our notice to stand.

7 So some licensees had called to question
8 what we intended to do.

9 Q. And have you ever threatened a full
10 withdrawal from a PRO as a negotiating tactic or
11 otherwise?

12 A. No, I don't threaten people as a
13 negotiating tactic, in any circumstance.

14 Q. Okay. Did Universal Music Publishing
15 Group recently move a catalogue from ASCAP to SESAC?

16 A. Yes, we did. We moved our production
17 music library, which is a rather small segment of
18 our total library or total catalogue focused on film
19 and TV music, which is why it is called production
20 music, essentially intended for background uses in
21 commercials and film and TV programming.

22 And that was the only segment of our
23 catalogue that we moved from ASCAP to SESAC.

24 JUDGE STRICKLER: Excuse me, counsel.
25 Mr. Kokakis, good afternoon.

1 THE WITNESS: Hello, Judge.

2 JUDGE STRICKLER: You had said a moment
3 ago you had never threatened withdrawal as a
4 negotiating tactic and you said you don't threaten
5 as a negotiating tactic. Do you bluff as a
6 negotiating tactic?

7 THE WITNESS: Certainly not in this
8 context, when it came to withdrawing performance
9 rights. The fact of the matter is that we intended
10 to withdraw because there were a lot of issues to
11 work through with BMI.

12 And we spent many, many sleepless nights
13 dealing with that. I personally recall canceling a
14 holiday vacation between the Christmas and New Year
15 kind of break that we have at our company and every
16 day was spent negotiating with BMI to work out
17 issues that came to light in the whole process of
18 withdrawing our partial rights.

19 Lack of transparency with the PROs and no
20 audit rights, so we have never for decades since
21 inception of any of these societies ever had any
22 visibility into how they account to us or what their
23 methodology is for accounting to us.

24 Lack of information when we would request
25 the terms upon which our rights were being licensed

1 to licensees, they just wouldn't share this
2 information, even though I believe we had the right
3 to know those types of terms. And we wanted those
4 things resolved before reaffiliating with BMI.

5 And if they hadn't been resolved, then we
6 wouldn't have reaffiliated. And we would have
7 probably had to figure out very quickly how to get
8 coverage for all of the BMI repertoire. Frankly, I
9 don't think it would have been us taking on the
10 licensing burden ourselves because of all of the
11 reasons that I just mentioned, millions of
12 investment capital that would be required to build
13 out the systems but, rather, we would have moved the
14 repertoire to another society.

15 And we had many suitors who were calling
16 at the time, other U.S. societies, foreign
17 societies, SOCAN, PRS, Sasson, which are the
18 societies in Canada, the U.K. and France
19 respectively.

20 And --

21 JUDGE STRICKLER: Did you bluff at any
22 point during those negotiations and say: Well, if
23 we can't get the information we want, we will
24 consider going to one of these other PROs?

25 THE WITNESS: Oh, did we bluff which

1 party? Do you mean, did we bluff BMI?

2 JUDGE STRICKLER: Yes.

3 THE WITNESS: I think we were quite
4 sincere about our intent to move if they didn't give
5 us what we were looking for. And we had extensive
6 conversations with the other societies, so we had a
7 plan B ready to go.

8 And our chairman and CEO at the time was
9 steadfast in his conviction that we needed to have a
10 plan B in place, just in case BMI didn't step up and
11 give us what we were looking for. So, no, I would
12 say we were not bluffing.

13 JUDGE STRICKLER: You wouldn't
14 characterize it as a threat or a bluff? It was a
15 statement of your plan B potential?

16 THE WITNESS: We had to have a plan B in
17 place.

18 JUDGE STRICKLER: And you made that known
19 to BMI?

20 THE WITNESS: And made that known to BMI
21 because they had questioned what our intentions
22 would be if we didn't come to an arrangement with
23 them. And I think they took the negotiation rather
24 seriously because they knew that we had the means to
25 withdraw and move the catalogue to another society,

1 which I think they were particularly afraid of
2 because it is one thing when a publisher may
3 withdraw to assume the responsibilities of direct
4 licensing and performance base itself, but it is
5 another to move the rights to a different society, a
6 competitor of BMI, then I don't think they liked the
7 prospect of that happening very much.

8 JUDGE STRICKLER: Thank you.

9 THE WITNESS: Certainly. Thank you,
10 Judge.

11 BY MR. SCIBILIA:

12 Q. Are you aware that the Copyright Owners
13 are seeking in this proceeding to clarify that the
14 late fee provision contained in the current
15 regulations applies not just to payments, late
16 payments by labels under Subpart A but also to late
17 payments by Services under Subparts B and C?

18 A. I'm aware of that, yes.

19 Q. And do you have a view as to whether such
20 a late fee is appropriate?

21 A. I think it is quite appropriate, yes.

22 Q. And why is that?

23 A. Well, we're accustomed as publishers to
24 the labels paying late fees when accountings are in
25 arrears. And with the Digital Services we

1 experienced the same type of dynamic we experienced
2 with the labels for years, which is inappropriate,
3 improper accountings, payments that sit at the
4 service level for many years before it is paid
5 through to the publishers.

6 And quite recently that led to a string
7 of settlements with different services addressing
8 what has become a very large pool of unallocated
9 revenue sitting at every Digital Service. It is not
10 unique to any particular one. But I don't know if I
11 could disclose the amounts or the terms -- no, okay,
12 I won't disclose amounts. But we're talking tens of
13 millions of dollars in revenue that should have been
14 paid through publishers that I said sat at the
15 Service level a moment ago but in some instances it
16 was actually spent by the Services and used for
17 costs such as overhead.

18 And it was not held in reserve with, I
19 believe, a good faith intent to pass that money
20 through to the publishers.

21 They essentially received royalty-free
22 music for many years with no intention of paying for
23 the use of that content.

24 Q. Do you have any understanding as to why
25 or what the causes of the late payments are by the

1 Digital Services?

2 A. I have had this discussion before with
3 several people, some sitting in this room,
4 representing the Digital Services. And everybody is
5 very quick to blame bad data, publisher data.

6 And -- as that being the reason why large
7 pools of money go unallocated, because the Service
8 can't match the use of a particular song to who owns
9 that song, so the Service doesn't know who to pay?

10 But to that I say it is not a data
11 problem, it is a problem when the Service makes a
12 decision to illegally use music because the fact of
13 the matter is that they are using the music first
14 and then trying to identify the owner of the music
15 after the fact, and in many instances unable to do
16 so, but they continue to use the music. They are
17 not adhering to the statutory formalities.

18 There is no notice of intent going out.
19 There is no backup notice being filed with the
20 Copyright Office. There is no good faith effort to
21 identify or pay through the money related to those
22 songs.

23 So it is unlicensed content. And the
24 Services make a decision, conscious decision, a
25 business decision, I don't think it is a legal one

1 or else they are not getting good advice from their
2 attorneys, to continue to exploit that material.

3 MR. ELKIN: I am going to make a motion
4 to strike. There is no foundation at all for these
5 statements.

6 THE WITNESS: May I address that?

7 BY MR. SCIBILIA:

8 Q. Mr. Kokakis, are you aware --

9 A. May I address that? There is a
10 foundation.

11 JUDGE BARNETT: No, just a minute.

12 THE WITNESS: I apologize, Your Honor.

13 JUDGE BARNETT: You are representing your
14 client at this point, not all of the Services?

15 MR. ELKIN: Yes, I have to, just
16 representing my client, although I think the same
17 could be ascribed to all of the Services.

18 JUDGE BARNETT: Well, you don't speak for
19 all the Services.

20 MR. MARKS: I will join the objection.

21 MR. CUNNINGHAM: We will join the
22 objection as well.

23 MR. MANCINI: We will join the objection.
24 Again, I think the motion is pending before you
25 which should cover this line of testimony as well.

1 JUDGE BARNETT: Okay. Then the
2 objections are noted. And if this is described in
3 the papers we will get to them. Thank you.

4 JUDGE STRICKLER: Before you move on,
5 counsel, a related question not dealing with the
6 objected-to testimony.

7 THE WITNESS: Yes.

8 JUDGE STRICKLER: One of the Services'
9 witnesses, at least one of them has floated the idea
10 of paying royalties that could not be identified
11 with a particular songwriter into an escrow fund, so
12 that they would pay, they wouldn't be paid late.

13 And I assume that means deferring to a
14 later date the ability to identify where those
15 royalties should go with the interest-bearing escrow
16 account. Is that something Universal would be
17 amenable to?

18 THE WITNESS: This is something that we
19 would be amenable to. And it is something we have
20 negotiated with some Services already via a
21 settlement through the NMPA, National Music
22 Publishers Association.

23 And I'm very proud that Universal
24 Publishing was the reason for these settlements
25 because we identified the unallocated revenue

1 problem many years ago, initially with a service
2 named MediaNet. And we assumed correctly that the
3 same type of unallocated revenue problem existed at
4 other Services.

5 And when I called several of them to
6 question whether they were encountering the same
7 sort of problem, they all admitted to it, which I
8 wanted to state in response to the objection, and
9 that led to settlement negotiations, some of which
10 have already resulted in settlement agreements being
11 entered into, some of which are being negotiated,
12 which in part address the issue that you are asking
13 about, which is how do we deal with this? Can it be
14 held in escrow?

15 Can it be subject to some sort of best
16 practices that is imposed on the Services to accrue
17 the money, hold it in an interest-bearing account,
18 we can make a good faith effort to continue to
19 match, to disclose what is unmatched to the
20 publishers, so we can take a pass at matching on our
21 own because it is our property that is essentially
22 being exploited and accruing all of this money.

23 So we would be amenable to that, but the
24 problem is that this is essentially the illegal
25 exploitation of music in the first place. So we

1 want to be careful about not creating a monster, so
2 to speak, in allowing Services or others out there
3 to just exploit music illegally and then just hold
4 the money on account until we go to knock on the
5 door to ask for it and identify it.

6 It is creating a shift in the burden and
7 a dynamic that we have to think through before we
8 simply agree to it.

9 JUDGE STRICKLER: Thank you.

10 THE WITNESS: Certainly. Thank you.

11 BY MR. SCIBILIA:

12 Q. Mr. Kokakis, are you an attorney?

13 A. I am, yes.

14 Q. And in dealing with digital licenses on a
15 regular basis, do you -- are you familiar with
16 Section 115 of the Copyright Act and its
17 implementing regulations?

18 A. Yes, I am.

19 Q. I think at this point we're going to move
20 into restricted material.

21 JUDGE BARNETT: Is there anyone -- oh,
22 there you are. If you have not signed the
23 nondisclosure agreement and are not otherwise able
24 to view or observe or listen to confidential
25 information, please wait outside. Thank you.

1 (Whereupon, the trial proceeded in
2 confidential session.)
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1	C O N T E N T S				
2	WITNESS	DIRECT	CROSS	REDIRECT	RECROSS
3	STEVE BOARD				
4		2990	3021		
5	RICHARD WATT				
6		3027	3115		
7	DAVID KOKAKIS				
8		3188	3245		
9					
10	AFTERNOON SESSION: 3113				
11					
12	CONFIDENTIAL SESSIONS: 3152-3163, 3219-3298				
13	E X H I B I T S				
14	EXHIBIT NO:	MARKED/RECEIVED		REJECTED	
15	GOOGLE				
16	758		3227		
17	760		3224		
18	801		3112		
19	PANDORA				
20	1074		3244		
21	1075		3244		
22	1076		3244		
23	1095			3275	
24	SPOTIFY				
25	1713		3186		

1	SPOTIFY:	MARKED ONLY	
2	6002	3164	
3	6003	3247	
4	EXHIBIT NO:	MARKED/RECEIVED	REJECTED
5	COPYRIGHT OWNERS		
6	2619	3030	
7	2679	3106	
8	2724	3106	
9	2725	3106	
10	2764	3112	
11	3018	3192	
12	3025	2992	
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CERTIFICATE

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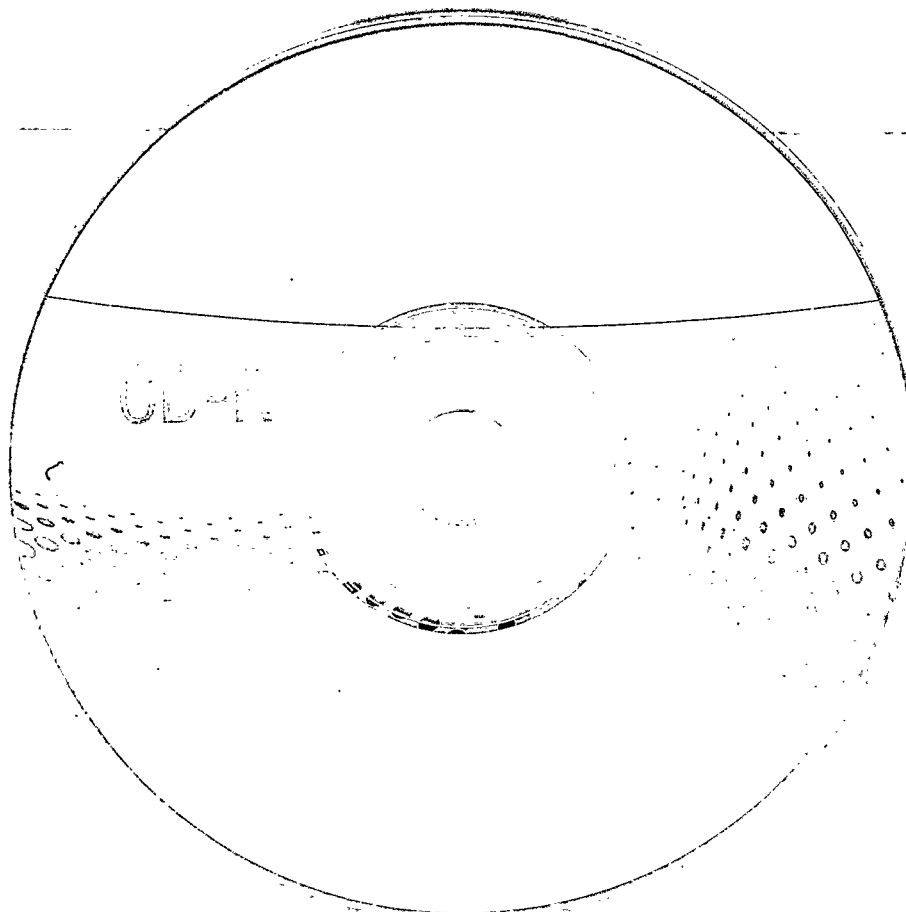
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I certify that the foregoing is a true and
accurate transcript, to the best of my skill and
ability, from my stenographic notes of this
proceeding.

3/28/17


Signature of the Court Reporter



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